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In the Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTION PRESENTED

Whether income derived by a tax-exempt medical association from the sale of commercial advertising space in its monthly journal is "unrelated business income" subject to tax under Sections 511 through 513 of the Internal Revenue Code.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-21a) is reported at 743 F.2d 1570. The opinion of the Claims Court (App., *infra*, 24a-33a) is reported at 3 Cl. Ct. 531.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 22a) was entered on September 17, 1984. A timely petition for rehearing was denied on December 5, 1984 (App., *infra*, 23a). On February 26, 1985, the Chief Justice extended the time within which to petition for a writ of certiorari to and including May 4, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 501, 511, 512, and 513 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Sections 1.512 and 1.513 of the Treasury Regulations on Income Tax (26 C.F.R.), are set out in a statutory appendix (App., *infra*, 35a-54a).

STATEMENT

1. The basic facts were stipulated below (C.A. App. 18A-22A). The American College of Physicians is an association exempt from tax under Section 501 (c) (3) of the Internal Revenue Code.[1] Its main purposes are to uphold high standards of medical education and practice and to encourage medical research (App., *infra*, 24a-25a). Membership in the College is open only to those engaged in practice, teaching, research, or other professional activities in the field of internal medicine (*id.* at 2a). Respondent had approximately 32,000 members in 1975 (C.A. App. 19A).

In furtherance of its tax-exempt educational purposes, respondent publishes a monthly journal entitled *Annals of Internal Medicine*. The journal contains scholarly articles relevant to the practice of internal medicine and is highly regarded in its field (App., *infra*, 2a). The journal is provided to respondent's dues-paying members without charge and to nonmembers on a per-issue basis or by subscription (*id.* at 25a). Its circulation in 1975 was roughly 73,000 (*id.* at 3a). Each issue contains commercial advertisements (including classified ads) relating to medical services and products, primarily drugs (*id.* at 25a).

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as in effect for the tax year at issue (the Code or I.R.C.).

It is respondent's policy to limit its advertising to those products and services that are useful in the practice of internal medicine (*id.* at 3a). Proffered advertisements are screened as to subject matter and as to the accuracy of their content (*ibid.*).

Many of the advertisements appearing in *Annals* are identical with those appearing in medical journals published by taxable commercial publishers, such as the *American Journal of Medicine*, which is put out by a division of Dun and Bradstreet (App., *infra*, 28a; C.A. App. 21A).[2] Some of the advertisements are eye-catching, others strictly factual; some cover a fraction of a page, others several pages; some are in black and white, many in bright color (App., *infra*, 28a). The advertisements are not dispersed throughout the journal but rather are grouped in discrete "stacks" at the beginning and end of each issue; the same format is generally followed in medical journals published by taxable commercial publishers (*id.* at 3a). The advertisements are deleted when the *Annals* are permanently bound.

The advertisements appearing in *Annals* are prepared by the advertisers and not by respondent (App., *infra*, 3a). Some of the ads are for established drugs and devices and are repeated from month to month (*id.* at 28a) No effort is made to coordinate the advertising with the journal's editorial content; thus, it would be coincidental for a drug that is discussed in an article to be featured in an advertisement in the same issue (*id.* at 28a n.3). Advertising space is made available at rates competitive with

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[2] Selected advertisements appearing in *Annals of Internal Medicine* and in *American Journal of Medicine* during January and February 1975 are reproduced in the appendix (App., *infra*, 55a-75a).

those charged for advertising space in other medical journals, whether published by taxable or tax-exempt entities (*id.* at 3a). According to a policy statement appearing in the July 1977 issue of *Annals*, what "justifies the incorporation of drug advertising in this journal" is the need to obtain "the financial support of drug houses" (C.A. App. 71A). Thus, it is an important source of revenue to respondent.

2. Sections 511 through 513 of the Code impose a tax on the "unrelated business income" of otherwise tax-exempt organizations like respondent. An "unrelated trade or business" is one the conduct of which "is not substantially related * * * to" (I.R.C. § 513(a)), *i.e.*, does not "contribute importantly to" (Treas. Reg. § 1.513-1(d)(2)), the accomplishment of the organization's charitable purposes. Section 513(c), entitled "Advertising, Etc., Activities," provides that an activity, such as advertising, which bears the earmarks of an unrelated trade or business "does not lose identity as [such] merely because it is carried on within * * * a larger complex of other endeavors," such as educational endeavors, that reflect an organization's tax-exempt function. The Treasury Regulations generally provide that "amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business" (Treas. Reg. § 1.512(a)-1(f)(1)).

Respondent's gross advertising revenue from *Annals* in 1975 was $1,376,322 (App., *infra*, 3a). After taking into account allowable offsets and deductions, respondent reported "unrelated business taxable income" of $153,388 on its 1975 tax return (*id.* at 4a). Respondent timely filed that return and

paid unrelated business income tax of $55,965 for that year (*ibid.*).

On June 12, 1979, respondent filed an administrative claim for refund of the tax thus paid (App., *infra*, 4a). When the IRS demurred, respondent, on August 17, 1982, instituted this refund suit in the Claims Court (*ibid.*). Respondent's principal contention was that its solicitation and publication of commercial advertising was "substantially related" to the performance of its educational purposes because "the advertising contains factual and technical data which * * * can help physicians keep up" with recent developments in medicine (*id.* at 27a-28a).

Following a trial, the Claims Court (Kozinski, C.J.) entered judgment for the United States. The court found respondent's principal argument—that the advertising in *Annals* "performs an educational function, supplementing the journal's editorial content" —to be "unpersuasive" (App., *infra*, 27a-28a). To begin with, the court noted, the "evidence is clear that [respondent] did not use the advertising to provide its readers a comprehensive or systematic presentation of any aspect of the goods or services publicized" (*id.* at 28a (footnote omitted)). Rather, "the comprehensiveness and content of the advertising package [was] entirely dependent on each manufacturer's willingness to pay for space and the imagination of its advertising agency" (*id.* at 30a). The advertising, moreover, was "typical commercial publicity" (*id.* at 28a). "Many ads were identical to those appearing in medical journals published by nonexempt organizations," any differences in format reflecting "the advertiser's marketing strategy rather than their probable importance to the reader" (*id.* at 28a-29a). Some of the advertising, the court observed, was for well-known and established products

like Valium, Insulin, and Maalox, a fact that "undermin[ed] the suggestion that the advertising was principally designed to alert readers of recent developments" (*id.* at 28a & n.4).

After thus evaluating the facts, the court noted that the Treasury Regulations provide that "advertising income of journals like *Annals* generally is taxable" (App., *infra*, 29a, citing Treas. Reg. § 1.512 (a)-1(f)). In holding that respondent's advertisements fall within this general rule, the court relied particularly on an Example set forth in the Regulations that "closely resembles the situation here" (App., *infra*, at 29a). That Example, involving a tax-exempt publisher of a professional journal, concludes that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute" (Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7)). The court found that respondent's advertising package served no "identifiable educational objective that goes substantially beyond the informational content" necessarily possessed by any advertising, that any educational function that the advertising may have served "was incidental to its purpose of raising revenue," and hence that "the advertising in *Annals* did not contribute importantly to the College's tax-exempt purposes" (App., *infra*, 30a).[3]

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[3] The Claims Court also rejected (App., *infra*, 30a-34a) respondent's alternative contention that its product advertising was carried on "primarily for the convenience of its members" and was exempt from unrelated business income tax on that basis. See I.R.C. § 513(a)(2). The Federal Circuit upheld the Claims Court's findings in this respect (App., *infra*, 19a) and we have no occasion to address that alternative contention here.

3. The Court of Appeals for the Federal Circuit reversed (App., *infra*, 1a-21a). Rejecting the trial court's findings, it concluded that the advertising in *Annals* contributes importantly to the accomplishment of respondent's educational purposes by "appris[ing] internists of developments in their field" (*id.* at 19a).

The court turned first to the legislative history accompanying Congress's enactment (in 1969) of Section 513(c), which, as noted above, is entitled "Advertising, Etc., Activities." While acknowledging language in the committee reports suggesting that Congress "may have believed that advertising income should be taxed," the court dismissed this legislative history on the ground that it "addresses advertising generally and does not grapple with specific factual situations" (App., *infra*, 12a-13a). As the court read the legislative history, Congress did not intend to "adopt a blanket rule" that commercial advertising revenues should be taxed, but rather left to the courts a case-by-case, ad-by-ad determination about whether or not particular advertisements are "substantially related" to an entity's tax-exempt function (*id.* at 17a-19a & n.23).

The court of appeals agreed with the Claims Court that the "primary purpose" of respondent's advertising was commercial and that its "educational function * * * may well have been secondary to the purpose of raising revenues" (App., *infra*, 19a). The court held, however, that "[t]he commercial character of the activity is not * * * determinative" (*id.* at 16a), and concluded that the trial judge, "apparently distracted by the commercial character of the advertisements," had erroneously evaluated them under "a more rigorous standard than is supported

by the statute" (*id.* at 16a, 18a). The court of appeals did not discuss, or even mention, the Treasury Regulations upon which the Claims Court had based its decision. Rather, relying on testimony of respondent's expert witnesses that the trier of fact had found "unpersuasive" (*id.* at 16a-17a, 28a), the court of appeals concluded that "the sales of advertising in *Annals* are substantially related to the exempt purpose of the College to educate internists" and that the Claims Court's conclusion to the contrary was "clearly erroneous" (*id.* at 19a).

The government's petition for rehearing, with suggestion for rehearing en banc, was denied (App., *infra*, 23a).

REASONS FOR GRANTING THE PETITION

The court of appeals has decided an important question of federal tax law in a way that conflicts directly with Congress's clearly-expressed intent in enacting Section 513(c). The decision below grants an exempt professional organization the very competitive edge over its taxpaying commercial counterparts that Congress was at pains to deny when it amended the Code specifically to bring advertising revenues within the reach of the unrelated business income tax. The decision below sub silentio invalidates long-standing Treasury Regulations that Congress considered in 1969 and upon which it placed its explicit imprimatur. The court of appeals' open-ended construction of the statutory phrase "substantially related" has considerable administrative importance: it will pave the way for many hundreds of trade and professional organizations to escape tax on their advertising income, and will impose tremendous burdens on limited IRS audit resources. The Claims Court is a court of

nationwide jurisdiction—any taxpayer can have its case heard there, with review in the Federal Circuit, simply by filing a refund suit—and the decision below is thus likely to be uncontradicted unless certiorari is granted. Review by this Court is therefore appropriate at this time.

1.a. The unrelated business income tax has its genesis in the Revenue Act of 1950, ch. 994, 64 Stat. 906 *et seq.* Before that law was enacted, charitable organizations that carried on ordinary trades or businesses were able to escape tax on their profits on the theory that the charitable "destination" of the revenues took precedence over their commercial "source." Thus, a nationwide vendor of macaroni (*C.F. Mueller Co.* v. *Commissioner*, 190 F.2d 120 (3d Cir. 1951)), and a commercial bathing beach facility (*Roche's Beach, Inc.* v. *Commissioner*, 96 F.2d 776 (2d Cir. 1938)), successfully claimed tax-exempt status simply because their business profits went to charity.

In the Revenue Act of 1950, Congress responded to this problem in two ways. First, it enacted the so-called "anti-feeder" provision (I.R.C. § 502(a)), under which organizations "operated for the primary purpose of carrying on a trade or business for profit" cannot claim tax exemption solely on the ground that their profits go to charity. Second, Congress enacted the "unrelated business income tax," now codified in Sections 511 through 515 of the Code. Those provisions generally require organizations that otherwise qualify for tax exemption to pay tax at regular corporate rates on income derived from any trade or business "the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits

derived) to the exercise or performance by such organization of its charitable, educational, or other [tax-exempt] purpose" (I.R.C. § 513(a)).

The chief impetus behind the new tax was Congress's desire to put the business operations of tax-exempt organizations on an equal footing with those of their taxable commercial counterparts. The House Report stated that "[t]he problem at which the tax on unrelated business income is directed * * * is primarily that of unfair competition." H.R. Rep. 2319, 81st Cong., 2d Sess. 36 (1950). The tax falls on business revenues, not on membership dues or investment income, since Congress regarded such sources of income as a traditional and proper mainstay for charitable institutions. S. Rep. 2375, 81st Cong., 2d Sess. 30-31 (1950). As amended by Congress in 1950, the Code "does not deny [a tax] exemption where the organizations are carrying on unrelated active business enterprises, or require that they dispose of such businesses, but merely imposes the same tax on income derived therefrom as is borne by their competitors" (H.R. Rep. 2319, *supra*, at 37).

b. During the ensuing years, uncertainty arose as to whether the unrelated business income tax extended to profits derived by tax-exempt organizations from the solicitation and sale of advertising space in their publications. See Lehrfeld, *The Unfairness Doctrine: Commercial Advertising Profits as Unrelated Business Income*, 23 Tax Law. 349, 351-352 (1970). The main argument against applying the tax in these circumstances was that the journal's articles and editorial content furthered the sponsoring organization's tax-exempt goals. Since the commercial advertisements arguably were part and parcel of a single trade or business ("publishing") with

an ultimately educational end, the unrelated business income tax was said to be inapplicable. See, *e.g.*, Weithorn & Liles, *Unrelated Business Income Tax: Changes Affecting Journal Advertising Revenues*, 45 Taxes 791, 798-800 (1967).

In 1967, the Treasury issued a Proposed Regulation formally announcing its intention to "fragment" tax-exempt publications into two components—commercial advertising, the income from which would be subject to unrelated business income tax, and articles and editorial content, the income from which would remain tax-free. Prop. Reg. § 1.513-1, 32 Fed. Reg. 5993 (1967). Following receipt of public comments, the Regulation was issued in final form eight months later. 32 Fed. Reg. 17657 (1967). It has remained substantially unchanged ever since.

Articulating the "fragmentation" concept, the new Regulation set forth the general rule that income-producing activities "do not lose identity as [a] trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization." Treas. Reg. § 1.513-1(b), 32 Fed. Reg. 17657. "Thus," the Regulation explained, "activities of soliciting, selling, and publishing commercial advertising do not lose identity as [a] trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to [its] exempt purposes" (*ibid.*).

To illustrate this principle, the Treasury set forth a pair of examples, each involving a professional association ("Z") that publishes a monthly journal containing scholarly articles and commercial advertis-

ing. Treas. Reg. § 1.513-1(d)(4)(iv) (Examples 6 & 7), 32 Fed. Reg. 17659. In Example 6, Z publishes "general consumer advertising" for products like "soft drinks, automobiles, articles of apparel, and home appliances." The Treasury concluded that such advertising revenues represented "gross income from [an] unrelated trade or business" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 6)). In Example 7, the facts are the same as in Example 6, "except that the advertising in Z's journal promotes only products within the general area of professional interest of its members." Example 7 elaborated the hypothetical facts as follows:

> Following a practice common among taxable magazines which publish advertising, Z requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, Z accepts advertising only from those who are willing to pay its prescribed rates.

Acknowledging that "continuing education of its members * * * is one of the purposes for which Z is granted exemption," the Treasury nevertheless concluded that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind

contemplated by the exemption statute." Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7). Thus, "Z's publication of advertising does not contribute importantly to the accomplishment of its exempt purposes; and the income which it derives from advertising constitutes gross income from unrelated trade or business" (*ibid.*).

c. The new Regulation triggered a storm of protest from tax-exempt publishers. During 1968, Congressmen sympathetic to their interests introduced numerous bills to block the Regulation's implementation. See Lehrfeld, *supra*, at 364-365; Weithorn & Liles, *supra*, at 792 n.8. These initiatives were unsuccessful. Extensive hearings were then held, attended by spokesmen for both the exempt and the non-exempt press. See *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. (1969) [hereinafter cited as *House Hearings*]; *Tax Reform Act of 1969: Hearings on H.R. 13270 Before the Senate Comm. on Finance*, 91st Cong., 1st Sess. (1969) [hereinafter cited as *Senate Hearings*]. Tax-exempt publishers of medical journals were well represented.[4] The witnesses repeatedly characterized the challenged Regulation as establishing a "presumption" or a "per se rule" that professional journal advertising income is subject to unrelated business income tax.[5] Those op-

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[4] See, *e.g.*, *House Hearings* 1259 (American Medical Ass'n); *id.* at 1211 (American Dental Ass'n); *id.* at 1117 (American Psychiatric Ass'n); *id.* at 1110 (American College of Physicians, respondent here).

[5] See, *e.g.*, *House Hearings* 928 (Regulation "indicate[s] that advertising is unrelated per se to an exempt purpose"); *id.* at 1113 (Regulation is "designed * * * to preclude even the possibility" that advertising income could escape tax); *id.* at 1188 ("all advertising in an organization publication is

posing the Regulation argued that the Treasury lacked statutory authority to "fragment" publishing activity and to treat commercial advertising as a "trade or business" distinct from the journal's editorial content. See, *e.g.*, *House Hearings* 1111, 1128-1129, 1184, 1213. And they contended that product advertising furthered their associations' tax-exempt purposes, *e.g.*, by educating doctors about new pharmaceutical products.[6] The non-exempt press, on the other hand, defended the Regulation as a check upon the perceived inequity and anti-competitive effect of affording a tax subsidy to their tax-exempt counterparts. See, *e.g.*, *House Hearings* 1150-1152, 1176-1177.

d. In the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 *et seq.*, Congress resolved the controversy by endorsing the Regulation and paving the way for its enforcement. Congress added to the Code new Section 513(c), entitled "Advertising, Etc., Activities." It provides that the term "trade or business" includes any activity "carried on for the production of income," and that "an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other en-

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now taxable"); *id.* at 1192 (Regulation effects "blanket taxation of all advertising"); *id.* at 1268 (Regulation creates a "presumption regarding advertising"); *Senate Hearings* 1670 ("all advertising is to be considered unrelated"); *id.* at 1705 (Regulation establishes "conclusive presumption * * * that all advertising [is] taxable").

[6] See, *e.g.*, *House Hearings* 1111-1112 (American College of Physicians); *id.* at 1119-1120 (American Psychiatric Ass'n); *id.* at 1214 (American Dental Ass'n); *id.* at 1261 (American Medical Ass'n).

deavors which may, or may not, be related to the exempt purposes of the organization." Those words, expressly sanctioning "fragmentation" of an activity into exempt-purpose and unrelated-business components, were taken almost verbatim from the 1967 Treasury Regulation promulgated to deal with the commercial advertising problem. Compare I.R.C. § 513(c) with Treas. Reg. § 1.513-1(b), 32 Fed. Reg. 17657 (1967).

The legislative history accompanying Section 513 (c) plainly shows that Congress intended to codify the treatment of advertising income prescribed by the 1967 Regulation. The Treasury Department took the position before Congress that the bill "codifies previously existing Treasury regulations defining activities such as advertising, which will be treated as unrelated business." *Senate Hearings* 568 (testimony of Assistant Secretary for Tax Policy Edwin S. Cohen); Staff of Senate Comm. on Finance, 91st Cong., 1st Sess., *Tax Reform Act of 1969 H.R. 13270: Technical Memorandum of Treasury Position* 34 (Comm. Print 1969). The House Report recites that the 1967 Regulation had "mainly affected the advertising income of publications such as medical journals," and stated that "[y]our committee wants to make clear that such regulations are valid." H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969). The Report then explains the new Section 513(c) as follows (*id.* at 50):

> Because of the ensuing controversy over this problem your committee has decided to deal with this subject by legislation. In general, it is in agreement with the purpose of the regulations. Your committee believes that a business competing with taxpaying organizations should not be

> granted an unfair competitive advantage by operating tax free unless the business contributes importantly to the exempt function. It has concluded that by this standard, advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore it believes that this income should be taxed.

The Senate Report is equally explicit. It notes the controversy over the 1967 Regulation and continues as follows (S. Rep. 91-552, 91st Cong., 1st Sess. 75 (1969)):

> The committee agrees with the House that the regulations reached an appropriate result in specifying that when an exempt organization carries on an advertising business in competition with other taxpaying advertising businesses, it should pay a tax on the advertising income. The statutory language on which the regulations are based, however, is sufficiently unclear so that substantial litigation could result from these regulations. For this reason, the committee agrees with the House that the regulations, insofar as they apply to advertising and related activities, should be placed in the tax laws.

The Report goes on to summarize the language of new Section 513(c), and concludes: "Under this provision, advertising income from publications (whether or not the publications are related to the exempt purpose of the organization) is to constitute unrelated business income to the extent it exceeds the expenses related to advertising" (S. Rep. 91-552, *supra*, at 75). The Treasury was directed to "prescribe regulations indicating the appropriate methods for allo-

cating income and expenses" as between taxable product advertising and tax-exempt editorial content (*id.* at 76).[7]

2. Surveying this legislative history, the court of appeals concluded that Congress in 1969 laid down no "blanket rule" (App., *infra*, 12a) about commercial advertising in tax-exempt professional journals. The court believed, rather, that Congress had left the door ajar and consigned to the courts a case-by-case, ad-by-ad determination as to whether *some* advertisements in *some* journals are "substantially re-

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[7] Those regulations were issued six years later. 40 Fed. Reg. 58637 (1975). They provide generally that "[u]nder section 513 * * * and § 1.513-1, amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business." Treas. Reg. § 1.512(a)-1(f)(1). They then set forth detailed allocation rules for advertising income and expenses. Treas. Reg. § 1.512(a)-1(f)(2) through (7).

As both the Senate Report and the commentators predicted, the 1967 Regulation did generate "substantial litigation" (S. Rep. 91-552, *supra*, at 75) concerning its application to tax years antedating Congress's enactment of Section 513(c). Indeed, two courts declared the Regulation invalid as applied to pre-1970 tax years, reasoning that the Treasury previously lacked statutory authority to "fragment" publishing activity into taxable and tax-exempt components. See *Massachusetts Medical Soc'y* v. *United States*, 514 F.2d 153, 154 (1st Cir. 1975); *American College of Physicians* v. *United States*, 530 F.2d 930, 933 (Ct. Cl. 1976). In so holding, the Court of Claims recognized that Congress in 1969 "prospectively amended [Section 513] to validate the 1967 regulations," and it accordingly limited its decision to tax years before the effective date of that enactment (530 F.2d at 930-931 n.2). The taxpayer in the First Circuit case—like respondent, a tax-exempt publisher of a medical journal—"acknowledge[d] that its advertising activities [came] within the new regulations' definition of an unrelated trade or business" (514 F.2d at 154).

lated" to the publisher's exempt purpose and are thus immune from tax (see App., *infra*, 13a, 19a & n.23). In overturning the Claims Court's findings, moreover, the court of appeals implied that the advertising in *Annals* is somehow distinguishable from the common run of advertising that does fall within the area of Congress's attention and concern.

The court of appeals erred in each step of its analysis. To begin with, Congress in 1969 quite plainly did adopt a presumption or "blanket rule" that commercial advertising income of professional journals is subject to tax. The 1967 Treasury Regulation, which Congress explicitly approved and determined to "place[ ] in the tax laws" (S. Rep. 91-552, *supra*, at 75), was uniformly interpreted, both by the witnesses who testified against it [8] and by leading commentators, as creating a presumption to that effect.[9] Indeed, the Regulation unequivocally states that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute." Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7). And Congress made clear that, under the statutory standard it was adopting,

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[8] See pages 13-14 note 5, *supra*.

[9] See, *e.g.*, Lehrfeld, *supra*, at 355 ("*per se* rule"); Weithorn & Liles, *supra*, at 806 ("*all* journal advertising constitutes unrelated business") (emphasis in original); Moore, *Current Problems of Exempt Organizations*, 24 Tax L. Rev. 469, 475 (1969) ("the regulations take the position that all advertising revenues of journals of tax-exempt organizations constitute a separate trade or business"); Middleditch & Webster, *The new unrelated business income Regs: what they mean; how to cope with them*, 28 J. Tax. 174, 175 (Mar. 1968) ("Under the new Regulations, all advertising in an organization publication is now taxable").

"advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore * * * this income should be taxed" (H.R. Rep. 91-413 Pt. 1, *supra*, at 50). Although the presumption Congress enacted may admit of exceptions,[10] Congress plainly intended that the exceptions would be rare indeed.[11]

Secondly, there is no suggestion anywhere in Section 513(c) or its legislative history that Congress intended the courts to confer ad hoc immunity from the unrelated business income tax depending on their subjective, case-by-case evaluation of how "importantly" particular advertisments contribute to a tax-exempt publisher's goals. The Regulations do provide that whether an activity is "substantially related" to an exempt purpose generally "depends in

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[10] The chief exception recognized by the Treasury Department concerns advertising published in a student-run campus newspaper, where "solicitation, sale, and publication of the advertising are conducted by students, under the supervision and instruction of the university." Treas. Reg. § 1.513-1(d)(4)(iv) (Example 5). The Example concludes that, under these circumstances, publication of the advertising contributes importantly to the university's educational goals "by means of student instruction of other students in the * * * advertising activities and student participation in those activities." See also Rev. Rul. 76-93, 1976-1 C.B. 170 (recognizing exception for advertisement which contains no commercial message but merely lists a company's name, along with the names of 59 other corporate "patrons," on a single page).

[11] As one commentator put it (rather ironically, as it turns out): "[I]t is arguable [after the enactment of Section 513(c)] that there can still be 'related' advertising. However, the legislative history and intent of the Congress is so clear that the likelihood of this argument prevailing as to any period after December 31, 1969 is very improbable." Webster, *Unrelated Business Income*, 23 Tax Law. 471, 476 (1970).

each case upon the facts and circumstances involved" (Treas. Reg. § 1.513-1(d)(2)). However, Congress and the Treasury Department have definitively undertaken this calculus with respect to professional journal advertising activities in particular, and have determined, as a matter of law, that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). There is simply no room for courts to second-guess that determination by purporting to "find facts," and thereby defeat the very uniformity and even-handedness of tax treatment that Congress sought to achieve.

Finally, the court of appeals erred in thinking that the advertising in *Annals* is somehow different from the common run of advertising that Congress clearly intended to tax. To the contrary, the pharmaceutical product advertising involved here was at the core of the problem Congress addressed in 1969. Far from being exceptional, respondent's advertising is of the garden-variety commercial type and it vies successfully in the marketplace for advertisers' dollars. The court of appeals did not disturb the Claims Court's findings that "[t]he advertising * * * was typical commercial publicity" (App., *infra*, 28a) and that "[t]he advertising business of *Annals* was operated in material respects like the advertising business of any other publication" (*id.* at 33a). Respondent's ads, like those held taxable in the Regulation Congress approved, are "designed and selected in the manner of ordinary commercial advertising" and their "informational function * * * is incidental to the controlling aim of stimulating demand for the

advertised products" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). Indeed, the Court of Claims found on an earlier occasion that "*Annals* regularly competes for advertising income with commercially published medical journals which, because of their non-exempt status, must in some instances charge higher rates than [respondent]." *American College of Physicians* v. *United States*, 530 F.2d at 931.

Contrary to the court of appeals' belief, moreover, it makes no difference that respondent's advertisements are "screened with respect to subject matter [and] accuracy" (App., *infra*, 17a) or that they "served to apprise internists of developments in their field" (*id.* at 19a). The advertisements described in the Regulation are also screened to ensure that they "comply with certain general standards of taste, fairness, and accuracy," and those advertisements also relate exclusively to "products * * * within the general area of professional interest of [the association's] members" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). Indeed, the Regulation makes clear that "professional interest" advertising, for products like drugs and medical devices, and "general consumer advertising," for products like soft drinks, automobiles, and appliances, are to be treated exactly the same way for purposes of the unrelated business income tax. Compare *id.* (Example 6) with *id.* (Example 7).[12] The Regulation thus recognizes the sim-

[12] See also Staff of Joint Comm. on Internal Revenue Taxation, 91st Cong., 1st Sess., *Summary of Problems Included in Tax Reform Hearings Dealing with Tax-Exempt Organizations* 4 (Comm. Print 1969) ("The advertising income is subject to tax under the existing regulations whether or not the advertising is with respect to a product which itself may be related to the exempt activity of the organization involved").

ple reality that, to the extent the advertiser is charged a fee as a condition of publication of the advertisement, the message is that of the advertiser rather than one to which the journal would choose to devote its own, general resources. A long line of this Court's decisions confirms that interpretive rulings by the Treasury, "if found to 'implement the congressional mandate in some reasonable manner,' must be upheld." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 476 (1979) (quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973)). And here the Regulation not only implements the congressional mandate but was specifically endorsed by Congress when it enacted the mandate in question.

In sum, the decision below invalidates sub silentio a Treasury Regulation that, having been explicitly approved by Congress, the court of appeals apparently did not dare invalidate in terms. In permitting respondent to operate its commercial advertising venture tax-free while its business rivals must pay tax, the court of appeals has adopted a controlling legal standard that flies in the face of Congress's design to achieve parity of treatment between exempt and non-exempt entities that publish advertisements for profit.

3. The question presented has considerable administrative importance. The reasoning of the decision below would apparently apply to virtually every tax-exempt professional or trade journal in the country. Associations of lawyers, chemists, engineers, computer programmers, and water pollution experts, no less than of doctors, can plausibly contend that their members' professional competency is enhanced by updated information contained in advertisements for

new products and services. According to *Folio: 400/1982*, a publishing industry compilation, there were in 1981 some 5,730 trade journals in the country, earning about $2.8 billion in revenues, the bulk of which came from advertising. Although it is difficult to tell how many of these journals currently are published by tax-exempt organizations, estimates before Congress in 1969 put the number at 700, with gross advertising revenues of about $110 million. Weithorn & Liles, *supra*, at 791. Those numbers can be expected to have grown since. According to postal service statistics, some 150 million pounds of commercial advertising were contained in exempt organization publications mailed during 1982 using special second class postage rates. U.S. Postal Service, *Revenue, Pieces and Weight* (1982).

The revenue impact of the decision below would likewise be substantial. Tax-exempt publishing is a big business. Of the 400 largest magazines in the Nation in 1981, at least 45 were published by tax-exempt organizations. In the medical field alone, they include the *Journal of the American Medical Association* (with 1983 advertising revenues of $14,207,000); the *New England Journal of Medicine* (with 1983 advertising revenues of $12,000,000); *American Medical News* (with 1983 advertising revenues of $8,497,000); and respondent's *Annals of Internal Medicine* (with 1983 advertising revenues of $4,637,000). See *Folio: 400/1984*, at 57, 60, 65. Indeed, the IRS estimates (based on industry sources) that between 20% and 25% of all commercial advertising in the medical field is published in exempt organization periodicals. The IRS advises that there are either currently pending or closed within the last two years some 200 examinations of advertising in exempt organization periodicals, in

which tax deficiencies totalling $29.6 million have been proposed. The Service estimates that almost half its total collections from the unrelated business income tax are attributable to revenues from commercial advertising in professional and trade journals.

Aside from the revenue impact, the decision below would impose formidable burdens on IRS audit resources. Under the (heretofore unquestioned) regulatory presumption that commercial advertising is taxable, IRS examiners were not required to investigate the "educational" function of advertisements on a case-by-case basis; the agent's task was simply to identify the ad as being for a *commercial* product or service. Under the decision below, by contrast, IRS agents will apparently have to determine, on a case-by-case, ad-by-ad basis, which commercial advertisements "contribute importantly" to the publisher's exempt function and which do not.[13] As a witness testified before Congress in 1969, "[t]o draw the line on an individual basis * * * and to say that this is advertising which is unrelated and that [that is] advertising [which] is related would present to the IRS[,] and taxpayers generally, an almost insurmountable audit problem." *House Hearings* 1184

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[13] The court of appeals, for example, highlighted an advertisement placed in *Annals* for *Medical Economics* (App., *infra*, 60a), a magazine that offers financial and tax advice to doctors, and suggested that it would not qualify as "substantially related" to the College's exempt function. See *id.* at 19a & n.23. But would the same be said about an advertisement placed by an interior decorating firm that specializes in doctors' offices? And does a drug advertisement serve an educational purpose when the product is widely known and has been available (say) for 15 years? The IRS advises that the amount of time required to audit tax-exempt publishers might increase by as much as 50% by the need to answer questions like these.

(American Society of Association Executives). The existing Treasury approach, by establishing a general rule that commercial advertising is unrelated to exempt purposes, produces logical tax consequences and prevents journals from manipulating the tax outcome simply by advising their advertisers to insert incidental "educational" boilerplate in their ads. The court of appeals has discarded that analysis and has provided no workable standard to take its place.

Finally, the question presented is important because the unrelated business income tax has a significant regulatory function. Congress designed the tax, not just to raise money, but to keep the commercial endeavors of exempt and non-exempt competitors on a par. The decision below has flouted that sharply-defined legislative policy.

4. The decision below is the first by a court of appeals to consider the question presented here. The Court of Appeals for the Federal Circuit, however, is a court of nationwide jurisdiction. Any taxpayer, regardless of where he is domiciled or does business, can have his case heard in the Claims Court, with review in the Federal Circuit, simply by paying the contested tax and suing for a refund. 28 U.S.C. 1491. In the future, therefore, any solvent, well-advised taxpayer affected by this issue will unquestionably opt for the same venue as did respondent.[14] Unless

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[14] We are aware of three cases now pending in trial courts outside the Federal Circuit that raise the question presented here. There is no assurance, however, that any of these cases will reach a court of appeals. Indeed, our trial counsel in one of the cases (*American Medical Ass'n v. United States*, Civ. No. 82-C-7213 (N.D. Ill. 1982)) has been informed that the taxpayer plans to move for a voluntary dismissal under Fed. R. Civ. P. 41(a), a plan obviously motivated by the decision below. *In Florida Trucking Ass'n* v. *Commissioner*,

this Court grants certiorari, therefore, the decision below will in all likelihood prescribe the governing legal standard on the subject. We believe that the court's error is too important, both to Congress and to the IRS, to permit that to happen.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1985

No. 4884-84 (T.C. 1984), the "relatedness" issue involves only $3,225 in tax and may well wash out at the trial level; and in *American Academy of Family Physicians* v. *United States*, Civ. No. 84-0170-CV-W-4 (W.D. Mo. 1984), which is currently in settlement negotiations, the "relatedness" issue involves only $18,000 in tax and is dwarfed by numerous other issues in the case.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Appeal No. 84-715

THE AMERICAN COLLEGE OF PHYSICIANS, APPELLANT

v.

THE UNITED STATES, APPELLEE

Decided: September 17, 1984

Before BALDWIN, SMITH, and NIES, *Circuit Judges.*

SMITH, *Circuit Judge.*

In this federal income tax case, appellant American College of Physicians (College) appeals from a judgment of the United States Claims Court [1] holding the College is not entitled to the refund of taxes paid on income earned from sales of advertising space in the College's journal, *Annals of Internal Medicine* (*Annals*). We reverse.

Issue

The sole question presented in this appeal is one of first impression for this court: whether the reve-

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[1] *American College of Physicians* v. *United States*, 3 Cl. Ct. 531 (1983).

nues derived by the College from advertising in *Annals* constitute "unrelated business taxable income" derived from a trade or business the conduct of which is not substantially related to the exercise or performance by the College of its tax-exempt purposes or functions. This appeal involves the College's tax liability for the 1975 tax year.

Background

The College is an organization exempt from federal income taxation under 26 U.S.C. §§ 501(a) and 501(c)(3). Among its tax-exempt purposes are[2] "(1) to uphold and to maintain high standards in medical education, medical practice [and medical research]; (2) to encourage research, especially in clinical medicine, and (3) to foster measures for the prevention of disease and for the improvement of public health." Membership in the College is limited to members of the medical profession engaged in practice, teaching, research, or other pursuits in the field of internal medicine or in allied or related specialties.

Annals, a highly regarded medical journal in the field of internal medicine, is published by the College in furtherance of its tax-exempt purposes. *Annals* contains scholarly articles relevant to the practice of internal medicine, advertisements relating only to medical products, supplies, and equipment useful in the practice of internal medicine, and notices of positions, desired or available, in connection with the practice of internal medicine. *Annals* is available to members of the College as a benefit of membership

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[2] These purposes, *inter alia*, are set forth in the College's Articles of Incorporation.

and to nonmembers at a per issue price or by subscription. Circulation in 1975 was roughly 73,000.

Advertisements in *Annals* are "stacked" in two sections—at the front of, and behind, the editorial content—of each issue. Advertisements in medical journals published by commercial organizations are generally also grouped in stacks, rather than dispersed throughout an issue. The trial judge found that many of the ads appearing in *Annals* were identical to those appearing in medical journals published by nonexempt organizations. He also found that the advertising business of *Annals* was operated in material respects like the advertising business of any other publication.

Advertisements appearing in *Annals* were prepared by the advertisers and not by the College. The trial court found that the college did not use the advertising in *Annals* to provide its readers a comprehensive or systematic presentation of the goods or services publicized. Advertising space was made available in *Annals* at rates competitive with those charged by commercial organizations for advertising space in their medical journals.

The College has a long-standing policy of accepting only those advertisements relating to medical products (primarily drugs), supplies, and equipment useful in the practice of internal medicine and those classified advertisements of positions in connection with the practice of internal medicine. Proffered advertisements are screened for accuracy and relevance to internal medicine.

1975 Advertising Revenues.

In 1975, gross advertising income attributable to *Annals* was $1,376,322. Direct advertising costs were

$833,050. Circulation income and readership costs attributable to *Annals* in 1975 were $1,057,754 and $1,351,167, respectively. Another publication of the College, the *Bulletin*, produced an overall loss of $96,471. The College timely reported taxable income of $153,388 and paid federal income taxes of $55,965 on that income for the 1975 tax year.

Proceedings Below.

On or about June 12, 1979, the College filed with the Internal Revenue Service a timely claim for refund of these taxes. Failing to receive notice of disallowance of this claim, receipt of which was not waived, the College, on or about August 17, 1982, filed in the United States Claims Court suit for refund of the taxes. The trial court found that the advertising published in *Annals* is not substantially related to the College's exempt purposes nor is it published primarily for the convenience of the College's members. Accordingly, the revenues derived from advertising in *Annals* were held to be taxable. The College appeals.

The trial court's findings of fact are not to be set aside unless they are clearly erroneous. The legal conclusions of the trial court will not be set aside unless they are incorrect as a matter of law.[3]

Unrelated Business Taxable Income

The Internal Revenue Code provided at the relevant time, with certain exceptions not applicable here, that the income derived from the unrelated business

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[3] Fed. R. Civ. P. 52(a); *Heisig* v. *United States*, 719 F.2d 1153, 1158 (Fed. Cir. 1983).

of an organization which is exempt from taxation under 26 U.S.C. § 501(a) (1976) is taxable: [4]

> There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a normal tax and a surtax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income".

The College is an organization described in paragraph (2)—an organization exempt from taxation under 26 U.S.C. § 501(a) not eligible for certain exceptions. Section 512(a)(1) of title 26 of the United States Code provides:

> [T]he term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business * * *.

Section 513 provides: [5]

> The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of

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[4] 26 U.S.C. § 511(a)(1) (1976).

[5] 26 U.S.C. § 513(a) (1976).

> the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 * * * except that such term does not include any trade or business—
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> * * * * *
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> (2) which is carried on, in the case of an organization described in section 501(c)(3) * * * by the organization primarily for the convenience of its members * * *[.]

The definition provided in section 513 is explained by Treas. Reg. § 1.513-1(a) (1976):

> [U]nless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

There is no dispute in this case that the advertising income is from a trade or business that is regularly carried on. Thus, the only remaining issues are whether that activity is not substantially related to an exempt purpose or function of the organization, and, in any event, whether the advertising does not constitute an "unrelated trade or business" because it is covered by the exception of section 513(a)(2) as a trade or business which is carried on by the or-

ganization primarily for the convenience of its members.

"Substantially Related" Standard

The relevant Treasury regulations outline the analysis required under the "substantially related" element of section 513: [6]

> The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question—the activities, that is, of producing or distributing the goods or performing the services involved—and the accomplishment of the organization's exempt purposes.

The regulations proceed to delimit the type of relationship required: [7]

> Trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the

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[6] Treas. Reg. § 1.513-1(d)(1) (1976).

[7] Treas. Reg. § 1.513-1(d)(2) (1976).

> gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Further, the regulations provide that [8]

> [i]n determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which con-

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[8] Treas. Reg. § 1.513-1(d)(3) (1976).

> tribute importantly to the accomplishment of any exempt purpose of the organization.

Development of Section 513

Prior to 1950, the test for whether income received by a tax-exempt organization was taxable was the destination of those funds, not their source.[9] The predecessor provisions to sections 511-513 were promulgated in response to the abuse of tax-exempt status by certain tax-exempt organizations which were operating unrelated commercial enterprises purely as a source of revenue.[10]

The evils sought to be remedied by that legislation were specific and limited, although at the time the problem was spiraling. The First Circuit, in *Massachusetts Medical Society* v. *United States*, noted that [11]

> [i]n his message to Congress in 1950 President Truman sought legislation to correct "the few glaring abuses of the tax exemption privilege," stating that it had been "misused in a few instances to gain competitive advantage over private enterprise through the conduct of business and industrial operations entirely unrelated to educational activities." * * *

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[9] *Trinidad* v. *Sagrada Orden*, 263 U.S. 578, 581 (1924).

[10] *See C. F. Mueller Co.* v. *Commissioner*, 190 F.2d 120 (3d Cir. 1951).

[11] *Massachusetts Medical Soc'y* v. *United States*, 514 F.2d 153, 154 (1st Cir. 1975) (quoting *Hearings on Revenue Revision Before the House Committee on Ways and Means*, 81st Cong., 2d Sess. 4, 5 (1950)). *See also* H.R. REP. No. 2319, 81st Cong., 2d Sess. 36-37 (1950), S. REP. No. 2375, 81st Cong., 2d Sess. 29, 107 (1950).

Similarly, the Court of Claims, in addressing whether advertising in *Annals* was taxable during a different tax year, stated [12]

> [t]he 1950 Act was a fairly limited measure, designed to distinguish the customary activities of exempt organizations from the operation of independent business enterprises entirely unrelated to the educational purpose of the organization. The publication of advertising in tax-exempt educational journals was a well-established practice before 1950, and Congress did not intend to treat such advertising on a par with an independently run advertisement placement agency.

Prior to 1967, the Commissioner took no steps to tax the advertising income of professional journals of tax-exempt organizations. In that year, the Treasury amended its regulations to provide that commercial advertising does not lose its identity as a trade or business "even though the advertising is published in an exempt organization periodical which contains editorial matter related to the exempt purposes of the organization." [13] Hence, Treasury adopted a fragmentary definition of trade or business.

The First Circuit in *Massachusetts Medical Society*,[14] and the Court of Claims, in *American College of Physicians*,[15] rejected the fragmentary approach,

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[12] *American College of Physicians* v. *United States*, 530 F.2d 930, 933 (Ct. Cl. 1976) (resolved on grounds other than substantial relation of the activity to an exempt purpose).

[13] Treas. Reg. § 1.513-1(b) (1968).

[14] *Massachusetts Medical Soc'y*, 514 F.2d 153.

[15] *American College of Physicians*, 530 F.2d 930 (following reasoning of First Circuit in *Massachusetts Medical Soc'y*).

however, as inconsistent with the legislative history, with the treatment of deductions in the regulations, and with section 512(a) of the code, in favor of treatment of the integrated publication of a periodical as a "trade or business." In *American College of Physicians*,[16] the court did not reach the sole issue before us:

> Since we view as dispositive the issue of whether plaintiff's advertising activities, as a matter of law, constituted a "trade or business" for tax purposes—irrespective of whether the advertisements themselves are or are not substantially related to plaintiff's exempt purpose—we find it unnecessary to resolve this essentially factual dispute.

In the interim before the regulations were declared invalid, however, Congress enacted the Tax Reform Act of 1969 amending section 513.

Effect of Tax Reform Act of 1969 on Section 513.

The Government asserts that the enactment of section 513 pursuant to the Tax Reform Act of 1969 reflects a congressional intent to tax advertising revenues as an unrelated trade or business. Subsection (c) was added to section 513:[17]

> (c) Advertising, etc., activities
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> For purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale

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[16] *American College of Physicians*, 530 F.2d at 931 n.3.

[17] 26 U.S.C. § 513(c) (1976).

> of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

The Government avers that Congress expressly validated the regulations that were held invalid in *Massachusetts Medical Society* and in *American College of Physicians*. The Government, quite properly, recognizes that congressional action was not in response to the above cases.[18] Rather, the Government asserts that it reflects a broader policy decision to tax organizations such as the College. We disagree.

The Government relies on statements of the House Ways and Means Committee to the effect that it was anticipated that advertising income from a journal published by an exempt organization would constitute unrelated business income.[19] While the committee may have believed that advertising income should be taxed, it did not adopt a blanket rule. Rather, it

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[18] The Government recognizes that the cases were decided subsequent to amendment of the code by the Tax Reform Act of 1969 and involved tax years prior to the effective date of the amendment.

[19] H.R. REP. No. 413, 91st Cong., 1st Sess. at 50, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 1645, 1695-96. *See also* S. REP. No. 552, 91st Cong., 1st Sess. at 75-76, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 1645, 2104-05.

expressly preserved the exemption for those trade or business activities that contribute importantly to the exempt function. The legislative history addresses advertising generally and does not grapple with specific factual situations. Congress heard testimony that medical advertising in journals such as *Annals* is substantially related to the exempt purposes of organizations such as the College, yet, Congress made no change to the "substantial relation" or "convenience" tests of section 513(a). Instead, it amended the statute *only* to provide that advertising activity shall be treated as a separate trade or business for purposes of analysis.

The Government's reliance on *HCSC-Laundry* v. *United States*[20] is unavailing. That case held that a cooperative hospital service organization cannot qualify for tax-exempt status under section 501(c)(3) but, instead, may qualify only under section 501(e). The laundry was previously held exempt under section 501(c)(3)[21] which was unchanged by the addition of section 501(e).

Section 501(e), however, provided exact guidance in the treatment of cooperative service organizations and, in so doing, omitted any specific exemption for shared laundry organizations. In *HCSC-Laundry*, the specific provision, subsection (e), was held to control over the more general, subsection (c)(3), particularly in view of their interrelationship.

A different section of the code is involved in this case. Section 513(c) is not a "more specific" pro-

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[20] *HCSC-Laundry* v. *United States*, 450 U.S. 1 (1981).

[21] *Northern Cal. Cent. Servs., Inc.* v. *United States*, 591 F.2d 620 (Ct. Cl. 1979) (holding that despite enactment of § 501(e), a cooperative hospital laundry remained a § 501(c)(3) exempt organization—a position expressly rejected in *HCSC-Laundry*).

vision which governs the "more general" section 513 (a). Rather, subsection (c) defines the trade or business to be analyzed under the substantially related test of subsection (a). Nor are we convinced of the congressional purpose asserted by the Government. We conclude that the Government has not established that Congress intended to tax *all* advertising revenues of *all* journals of exempt organizations. Even were we to agree that Congress did so intend, it failed to carry that alleged intent forward into the statute with language appropriate to effect that result.

We conclude that Congress, in enacting section 513 (c), intended for advertising activity to be treated as a separate trade or business for purposes of the unrelated business income tax provisions. Section 513(a) expressly requires that, although considered a separate trade or business, the conduct of that advertising must be evaluated to determine whether it is not substantially related to an exempt purpose or function of the organization and to determine whether the conduct of the trade or business is not primarily for the convenience of the organization's members, before that income is taxable. The trial judge undertook that analysis and we conclude that he erred.

The trial judge attempted first to determine whether the conduct of the trade or business is not substantially related to the performance of the College's tax-exempt purposes. The College maintains that the advertising performs an educational function; a suggestion the court below found unpersuasive. The trial court focused instead on the commercial character of the advertising and on the degree of similarity to advertising activity carried on by commercial organizations. While it recognized the advertis-

ing had some degree of educational content, the trial court went on to state that:

> To avoid the [unrelated business income tax,] an exempt organization would have to run its advertising business much differently than did plaintiff. For example, it might make a concerted effort to provide advertising that comprehensively surveys a particular field, includes all recent developments in that field, or otherwise makes a systematic presentation on some subject relevant to the organization's exempt purposes. To qualify for exemption, the advertising package as a whole must serve an identifiable educational objective that goes substantially beyond the informational content of the individual advertisements. This standard is not met where, as here, the comprehensiveness and content of the advertising package is entirely dependent on each manufacturer's willingness to pay for space and the imagination of its advertising agency.

The court below found any educational function of the activity to be incidental to the purpose of raising revenue.

Having found the advertising in *Annals* not substantially related to the College's exempt purposes, the trial judge proceeded to determine whether it was nevertheless carried on primarily for the convenience of the College's members in their capacity as members of the College and not merely in their capacity as physicians. He found that the advertising business was not carried on primarily for the convenience of the College's members but, rather, for the primary purpose of raising revenue.

The College argues that the court below fashioned its own test—adding requirements unsupported by

statute, legislative history, or regulation. The trial court's test, avers the College, requires a noncommercial primary purpose. The College asserts that the trial court's decision is contrary to authority, relies on the Internal Revenue Service's generalizations that journal advertising is unrelated, and fails to recognize distinguishing facts present in this case. The Government, on the other hand, asserts that the trial court's decision is consistent with both the intent of Congress and the applicable Treasury regulations.

We agree with the College that the trial court erred in imposing a more rigorous standard than is supported by the statute. The trial court did not, however, impose tax liability merely because the primary purpose was found to be to raise revenue. It relied on a variety of factors, among them the similarity to the content and conduct of advertising in commercial publications.

The commercial character of the activity is not, however, determinative. Rather, it is the substantiality of the relationship—the importance of the contribution of that activity—to the performance of the College's exempt purposes or functions, that is determinative. The trial court's analysis places too great an emphasis on the similarity of the activity to commercial advertising. Sections 511-513 impose tax liability for revenues derived from activities that are not sufficiently related to the exempt purpose or function of the organization; not by virtue of the commercial character of that activity.

The exempt purpose or function urged by the College was the medical education of internists including, but not limited to, dissemination of medical and pharmaceutical information. The College's expert

witnesses testified regarding the need for continuing pharmacologic information, particularly in view of the rapid pace of developments in internal medicine. Testimony was also elicited regarding the essential function performed by drug advertising to disseminate information on recent developments with respect to new drugs, changes in dosage forms and strengths of existing drugs, and additional indications and contraindications discovered based on use. Finally, the College's experts testified that the advertising performed an essential "alerting" function to inform the physician of recent developments by disseminating information concerning those developments.

The trial court recognized that "all advertising is educational or informational to some degree." The College introduced evidence that the advertising carried in *Annals* is screened with respect to subject matter and its content controlled. Advertising is accepted only of products and services related to the practice of internal medicine. The accuracy of information in the advertisements appearing in *Annals* is regulated, in part by information mandated by the Food and Drug Administration. Further, the College screens new advertisements for relevance to the practice of internal medicine. Similarly, classified advertising in *Annals* is limited to advertisements directly relevant to the practice of internal medicine. The advertisements are also indexed by advertiser.

The trial court erred in requiring the activity to meet a standard higher than set out in the statute. We conclude the trial court erred in requiring that "[t]o qualify for exemption, the advertising package as a whole must serve an identifiable educational objective that goes substantially beyond the informa-

tional content of the individual advertisements." The trial court was apparently distracted by the commercial character of the advertisements and failed to focus properly on the substantiality of the relation of the information content of the advertisements to the College's educational function.

Comprehensive and systematic presentation of various aspects of the goods or services advertised, as the trial court would require, would doubtless enhance the strength of the relationship between the information content of the advertisements and the College's educational function. The failure to present the information in that manner, however, does not establish the lack of an important contribution to the exempt function of the advertisements that were published in *Annals*. While new advertisements could be considered of greater educational value than old, repeated ads, the trial court failed to examine the contribution of the old, repeated ads to the educational function. Similarly, systematic presentation of advertisements on some subject relevant to the College's educational function would doubtless further that educational purpose. However, the failure of the College to take additional steps that may have resulted in a more substantial relation to the exempt purpose does not establish that the content of the advertisements is not already substantially related to that purpose.

It was not necessary, in order to resolve the issue before it, for the trial court to find that the primary purpose of the advertising activity was to raise revenue. That finding is relevant only inferentially in that, if its primary purpose was commercial, the advertising business was not carried on *primarily* for the convenience of the College's members. The record presents a very close question, but we cannot con-

clude, on the basis of the record before us, that the trial court's finding, that the advertising was not carried on "primarily for the convenience of [the College's] members," is clearly erroneous. That the primary purpose may have been commercial, however, does not preclude a finding that the activity is substantially related to an exempt function.

We conclude that the trial court's finding, that the advertising in *Annals* is not substantially related to the College's tax-exempt, educational purpose, was clearly erroneous. While the educational function of the advertising may well have been secondary to the purpose of raising revenues, the evidence of record establishes that the advertising in *Annals* fulfilled an important educational function. The advertisements served to apprise internists of developments in their field. The trial court made no finding that the size and extent of the activity was excessive. On the basis of the evidence of record, the size and extent of the advertising activity appears to be reasonable in relation to the editorial content of *Annals*.[22]

The evidence of record establishes that the contribution of the advertisements to the exempt purpose is an important one. We hold that the sales of advertising in *Annals* are substantially related to the exempt purpose of the College to educate internists and, therefore, are not taxable under section 511.

Not all the advertisements that were published in *Annals*, however, would appear to be substantially related to the exempt educational function.[23] Treasury Reg. § 1.513-1(d)(3) (1976) provides

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[22] Treas. Reg. § 1.513-1(d)(3) (1976).

[23] The trial court cited the example of an advertisement for *Medical Economics* magazine, which offers financial and business advice to the practicing physician.

> where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. * * *

The Government, however, does not argue in this appeal that some portion of the advertising in *Annals* was in excess of what would be reasonably necessary for performance of the exempt function. Accordingly, it is not necessary for us to resolve that issue in this appeal.[24]

REVERSED

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[24] *Cf. Hi-Plains Hospital* v. *United States*, 670 F.2d 528, 533 (5th Cir. 1982) (holding that hospital pharmacy sales were substantially related to exempt function and remanding case to district court to resolve treatment of small amount of sales that were not substantially related to exempt purpose).

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Appeal No. 84-715

THE AMERICAN COLLEGE OF PHYSICIANS, APPELLANT

v.

THE UNITED STATES, APPELLEE

NIES, *Circuit Judge*, concurring.

I concur in result and join the opinion except in the following respect. In my view, a portion of appellant's advertising business "is carried on . . . by the organization primarily for the convenience of its members." In particular, the advertisements for positions in the field and for services and publications directed to members in their professional capacity, including the advertisement for *Medical Economics* magazine, would fall under this exemption.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

No. 84-715
415-82T

THE AMERICAN COLLEGE OF PHYSICIANS, APPELLANT

v.

THE UNITED STATES, APPELLEE

JUDGMENT

On Appeal from the U.S. Claims Court

This Cause having been heard and considered, it is Ordered and Adjudged: Reversed.

DATED September 17, 1984

Petition for Rehearing,
Denied, December 5, 1984
Suggestion for Rehearing
In Banc, Declined,
December 5, 1984.

ENTERED BY
ORDER OF THE COURT

/s/ George E. Hutchinson
GEORGE E. HUTCHINSON
Clerk

Issued as a Mandate: December 13, 1984

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

No. 84-715

THE AMERICAN COLLEGE OF PHYSICIANS, APPELLANT

v.

THE UNITED STATES, APPELLEE

ORDER

A petition for rehearing and a suggestion for rehearing in banc having been filed in this case,

UPON CONSIDERATION THEREOF, it is Ordered by the court that the petition for rehearing be, and the same is hereby, Denied.

The suggestion for rehearing in banc is declined.

FOR THE COURT

/s/ George E. Hutchinson
GEORGE E. HUTCHINSON
Clerk

Date: December 5, 1984

APPENDIX D

IN THE UNITED STATES CLAIMS COURT

No. 415-82T

AMERICAN COLLEGE OF PHYSICIANS, PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

[Filed Oct. 21, 1983]

OPINION

KOZINSKI, Chief Judge.

Plaintiff American College of Physicians, a tax-exempt organization, challenges the Commissioner's determination that income earned from advertising in the College's journal, *Annals of Internal Medicine*, is subject to the Unrelated Business Income Tax (UBIT). 26 U.S.C. §§ 511-513 (1976).

Facts [1]

The College is an organization exempt from taxation under section 501(c)(3). Its tax-exempt purposes are to uphold and maintain high standards in

[1] The court made oral findings of fact after trial which was held on September 14, 1983.

medical education, medical practice and medical research; to encourage research, especially in clinical medicine; and to foster measures for the prevention of disease and for the improvement of public health. In furtherance of its exempt purposes, the College publishes *Annals of Internal Medicine* which contains scholarly articles relevent to the practice of internal medicine. *Annals* has a worldwide reputation as one of the most respected journals in its field. The journal is provided to the College's members without charge and to nonmembers on a per issue basis or by subscription.

Each monthly issue of *Annals* contains commercial advertisements relating exclusively to medical products (primarily drugs) and classified notices relating principally to employment in the practice or teaching of medicine. These advertisements are not dispersed throughout the journal but appear in discrete "stacks" at the beginning and end of the publication. In general, the College's advertising rates are competitive with those of other medical journals.

Questions Presented

Sections 511-513 of the Internal Revenue Code provide that the income of otherwise tax-exempt organizations is taxable if it is earned by regularly conducting a trade or business not substantially related to the organization's exempt purposes. The parties have stipulated that the College's activity of soliciting and publishing advertisements in *Annals* was a regularly conducted trade or business. They disagree as to whether it is substantially related to the College's exempt purposes.

Even if publishing advertisements in *Annals* is held not to be substantially related to the College's exempt

purposes, the income is nevertheless tax-exempt if the advertisements are published primarily for the convenience of the College's members. 26 U.S.C. § 513 (a)(2) (1976). The parties further disagree as to whether the advertising in *Annals* meets this standard.

Discussion

A. *The Relatedness Issue*

Under section 513(a) the income from a trade or business is tax-exempt if the conduct of the trade or business is substantially related to the performance of the organization's tax-exempt purposes. To come within section 513, the relationship between the business and the tax-exempt purpose must be a substantial one, i.e. it must "contribute importantly" to the accomplishment of the organization's exempt purposes. Treas. Reg. § 1.513-1(d)(2) (1975).

1. Defendant argues that, to avoid the UBIT, the very conduct or operation of the business, rather than merely its product, must be substantially related to the tax-exempt purpose. To illustrate this proposition, defendant refers to an example in the regulations which concludes that income from advertisements solicited by a student-run newspaper is tax-exempt. Treas. Reg. 1.513-1(d)(4)(iv) example (5) (1975). Defendant explains that students working on the paper are engaging in an educational activity: learning how to run a newspaper. The publication of advertising teaches students how to solicit business, set prices and lay out ads. The income for the advertising is exempt, defendant argues, because the very operation of the advertising business contributes importantly to the educational function. Whether the advertisements themselves advance the organization's tax-exempt purposes is, in defendant's view, irrelevant.

While defendant's test fits neatly within the example given, it is not clear that the Commissioner has consistently followed it. *See, e.g.*, Rev. Rul. 75-516, 1975-2 C.B. 220; Rev. Rul. 69-463, 1969-2 C.B. 131; Rev. Rul. 69-267, 1969-1 C.B. 160.[2] At least until the Internal Revenue Service itself takes a position more consistent with the view suggested by its attorney, the court will consider whether the conduct *or* the product of a business is related to the organization's tax-exempt purposes.

2. Plaintiff does not contend that the conduct of the advertising business is substantially related to the College's exempt purposes, so the inquiry is whether the advertising itself is so related. Plaintiff's theory is that the advertising performs an educational function, supplementing the journal's editorial content. Medicine is a constantly changing

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[2] In Rev. Rul. 69-267, 1969-1 C.B. 160, for example, a hospital operated a gift shop patronized by patients, visitors and employees. The operation of the gift shop was held to be substantially related to the hospital's exempt purposes because "[b]y providing a facility for the purchase of merchandise and services to improve the physical comfort and mental well-being of its patients, the hospital is carrying on an activity that encourages their recovery and therefore contributes importantly to its exempt purposes." There is no indication that the gift shop was operated by patients; its relationship to the hospital's tax-exempt purpose lay in the fact that the goods and services it provided could enhance the comfort of the patients. *See also* Rev. Rul. 69-268, 1969-1 C.B. 160 (hospital cafeteria is substantially related); Rev. Rul. 69-269, 1969-1 C.B. 160 (hospital parking lot is substantially related). While each of these operations might have been deemed tax-exempt as operated primarily for the convenience of the patients, *see* pp. 5-7 *infra*, the Commissioner chose instead to rule that they were substantially related to the hospital's tax-exempt purpose.

science and the advertising contains factual and technical data which, according to plaintiff, can help physicians keep up.

The court finds plaintiff's argument unpersuasive. The evidence is clear that plaintiff did not use the advertising to provide its readers a comprehensive or systematic presentation of any aspect of the goods or services publicized.[3] Those companies willing to pay for advertising space got it; others did not. Moreover, some of the advertising was for established drugs or devices and was repeated from one month to another, undermining the suggestion that the advertising was principally designed to alert readers of recent developments.[4] Some ads even concerned matters that had no conceivable relationship to the College's tax-exempt purposes. *See, e.g.*, n. 7 *infra*.

The advertising, moreover, was typical commercial publicity. Some ads were eye-catching, others strictly factual; some covered a fraction of a page, others several pages; some were in black and white, many were in bright color. Many ads were identical to those appearing in medical journals published by non-exempt organizations. The differences between ads plainly reflected the advertiser's marketing strat-

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[3] The hit-or-miss nature of the advertising was highlighted by one of plaintiff's own witnesses who suggested that ads could help readers understand the journal's editorial content by supplementing articles discussing a particular drug or medical device. Yet it is clear that no effort was made to coordinate the advertising with the journal's editorial content. Thus, if an article discussed a particular new drug or device, it would be pure coincidence for that product also to be featured in an advertisement in the same issue of the journal.

[4] For example *Annals* often carried ads for Valium, Insulin and Maalox. *See, e.g., Annals of Internal Med.*, July 1975 at I-0, I-58 & I-64.

egy rather than their probable importance to the reader. That the advertisements were placed in stacks—a fact upon which plaintiff places significant reliance—had no bearing on their purported educational function. It suggests instead that the ads were considered distracting and out of step with the sober and understated tenor of the journal's editorial content.

All advertising is, of course, educational or informational to some degree. However, Treasury Regulations provide that advertising income of journals like *Annals* generally is taxable. Treas. Reg. § 1.512(a)-1(f) (1975). Example 7 under Treas. Reg. § 1.513-1(d)(4)(iv) closely resembles the situation here, positing a tax-exempt organization that sells advertising space in its journal but limits the advertising to matters within the professional interest of its members. The organization requires the advertising to conform to certain standards of taste, fairness and accuracy, but otherwise leaves the content and form of the advertising to the discretion of the advertisers. Despite the informational character of the advertising, the example concludes that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute."

To avoid the UBIT an exempt organization would have to run its advertising business much differently than did plaintiff. For example, it might make a concerted effort to provide advertising that comprehensively surveys a particular field, includes all recent developments in that field, or otherwise makes a systematic presentation on some subject relevant to the organization's exempt purposes. To qualify for

exemption, the advertising package as a whole must serve an identifiable educational objective that goes substantially beyond the informational content of the individual advertisements. This standard is not met where, as here, the comprehensiveness and content of the advertising package is entirely dependent on each manufacturer's willingness to pay for space and the imagination of its advertising agency.

The court therefore finds that the advertising in *Annals* did not contribute importantly to the College's tax-exempt purposes. Rather, any educational function it may have served was incidental to its purpose of raising revenue.

B. *The Convenience Issue*

Even though the advertising in *Annals* is not substantially related to the College's exempt purposes, the income gained from it would nevertheless be tax-exempt if the advertising business was carried on primarily for the convenience of the College's members. 26 U.S.C. § 513(a)(2) (1976).

1. There is little guidance on the subject of when income subject to the UBIT nevertheless remains tax-exempt because it derives from activities conducted primarily for the convenience of the organization's members. The statute itself simply provides that "the term 'unrelated trade or business' . . . does not include any trade or business . . . which is carried on . . . by the organization primarily for the convenience of its members . . . ." 26 U.S.C. § 513(a)(2)(1976). In order to qualify under this language, it would appear that the activity in question has to be carried on for the convenience of the organization's members in their capacity as members. Were the statute construed otherwise, there would be no end to the types of goods or services an organization could provide its

members while avoiding tax on the income so derived. This would significantly undercut the purpose of the UBIT.[5]

While the legislative history of section 513(a)(2) is sparse, it supports this interpretation. The House and Senate Reports give the examples of dining rooms, restaurants and dormitories operated by a university for use by its students as falling within this exception. H.R. Rep. No. 2319, 81st Cong., 2d Sess. 37 (1950), *reprinted in* 1950-2 C.B. 380, 409; S. Rep. 375, 81st Cong., 2d Sess. 29 (1950), *reprinted in* 1950-2 C.B. 483, 505. Each of these examples involves facilities that assist students in fulfilling their role as students. For example, dormitories allow students to live close to classrooms and libraries, and to share quarters with other students. On campus restaurants and cafeterias facilitate student interaction before, after and between classes.[6] *See also*

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[5] Thus, tax-exempt organizations could, as a side-line, operate vacation resorts, catalogue shopping services, apartment houses or any other enterprises so long as access were largely limited to members. All such enterprises could be described as operating for the convenience of the members, yet their activities would be entirely unrelated to the organization's tax-exempt purposes. Allowing organizations to engage in such enterprises tax free would raise concerns about unfair competition with taxable entities; such concerns were the principal impetus for enactment of the UBIT. *See Disabled American Veterans* v. *United States*, 227 Ct. Cl. 474, 479 (1981); H.R. Rep. No. 2319, 81st Cong., 2d Sess. 36 (1950), *reprinted in* 1950-2 C.B. 380, 409; S. Rep. No. 2375, 81st Cong., 2d Sess. 28 (1950), *reprinted in* 1950-2 C.B. 483, 504; Treas. Reg. § 1.513-1(b) (1975).

[6] The Supreme Court has recognized that student interaction serves an important educational function. *See Sweatt* v. *Painter*, 339 U.S. 629, 634 (1950); *McLaurin* v. *Oklahoma State Regents*, 339 U.S. 637, 641 (1950).

St. Luke's Hospital v. *United States*, 494 F. Supp. 85, 92 (W.D. Mo. 1980) (pathology tests performed by hospital primarily for the convenience of member physicians).

The advertising here may have served the convenience of *Annals* readers in their capacity as physicians but not in their capacity as members of the College. The difference is subtle but important. The members' interests as members concern such matters as attending the College's educational functions, participating in research and testing, disseminating health information to the public and promoting quality medical education. The members' interests as physicians are much broader and include all of the aspects of medical practice. The advertising in *Annals* may assist practicing physicians by informing them of new products, publicizing the availability of positions and helping them sell their medical equipment. The advertising does not, however, have any connection with their responsibilities as members of the College.[7]

2. In any event, the court finds that the advertising business was not carried on *primarily* for the convenience of the College's members in any capacity. In another context, the Supreme Court has interpreted the term "primarily" to mean "'of first im-

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[7] An advertisement for another publication, *Medical Economics*, illustrates this point. The ad, which appeared regularly in *Annals*, promised that *Medical Economics* would help provide answers to such questions as whether "the new Seville [is] worth its $12,479 base price" and that it would instruct readers on how to "double [their] gain through a quirk in the tax law." *Annals of Internal Med.*, July 1975 at I-40. While such issues may be of interest to the reader, their resolution surely has no bearing on his responsibilities as a member of the College.

portance' or 'principally.'" *Malat* v. *Ridell* [sic], 383 U.S. 569, 572 (1966) (construing section 1221(1) of the Internal Revenue Code which denies capital gain treatment to "property held . . . primarily for sale . . . in the ordinary course of . . . business"). There seems to be no reason to depart from this common sense definition in interpreting section 513(a)(2).

The advertising business of *Annals* was operated in material respects like the advertising business of any other publication. All advertising serves the convenience of some of those seeing it, otherwise it would be ineffective and unprofitable. However, the primary purpose of advertising from the publisher's perspective is to make money. While the enhanced convenience of the readers may have been a welcome incidental benefit, the court finds that the College's primary purpose in carrying advertising in *Annals* was to raise revenue.

Conclusion

The advertising published in *Annals* is not substantially related to the College's exempt purposes nor is it published primarily for the convenience of the College's members.

The clerk is directed to dismiss the petition with costs to the prevailing party.

APPENDIX E

IN THE UNITED STATES CLAIMS COURT

No. 415-82 T

AMERICAN COLLEGE OF PHYSICIANS

v.

THE UNITED STATES

[Filed Oct. 24, 1983]

JUDGMENT

Pursuant to the opinion of October 21, 1983, it was held that plaintiff is not entitled to recover with the complaint to be dismissed.

IT IS ORDERED AND ADJUDGED this date, pursuant to Rule 58, that the complaint is dismissed, with costs to the prevailing party.

FRANK T. PEARTREE
Clerk of Court

APPENDIX F

Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the years at issue:

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

(a) *Exemption From Taxation.*—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

(b) *Tax on Unrelated Business Income and Certain Other Activities.*—An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in parts II and III of this subchapter, but (notwithstanding parts II and III of this subchapter) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(c) *List of Exempt Organizations.*—The following organizations are referred to in subsection (a):

(1) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes.

(2) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less ex-

penses, to an organization which itself is exempt under this section.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures

to the benefit of any private shareholder or individual.

(7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

* * * * *

SEC. 511. IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS.

(a) *Charitable, Etc., Organizations Taxable at Corporate Rates.*—

(1) *Imposition of tax.*—There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a normal tax and a surtax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income."

(2) *Organizations subject to tax.*—

(A) *Organizations described in section 401(a) and 501(c).*—The taxes imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from tax-

ation under this subtitle by reason of section 501(a).

(B) *State colleges and universities.*—The taxes imposed by paragraph (1) shall apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions. Such taxes shall also apply in the case of any corporation wholly owned by one or more such colleges or universities.

* * * * *

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) *Definition.*—For purposes of this title—

(1) *General rule.*—Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

* * * * *

(b) *Modifications.*—The modifications referred to subsection (a) are the following:

(1) There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.

(2) There shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

(3) In the case of rents—

(A) Except as provided in subparagraph (B), there shall be excluded—

(i) all rents from real property (including property described in section 1245(a)(3)(C)), and

(ii) all rents from personal property (including for purposes of this paragraph as personal property any property described in section 1245(a)(3)(B)) leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

(B) Subparagraph (A) shall not apply—

(i) if more than 50 percent of the total rent received or accrued

under the lease is attributable to personal property described in subparagraph (A)(ii), or

(ii) if the determination of the amount of such rent depends in whole or in part on the income or profits derived by any person from the property leased (other than an amount based on a fixed percentage or percentages of receipts or sales).

(C) There shall be excluded all deductions directly connected with rents excluded under subparagraph (A).

* * * * *

SEC. 513. UNRELATED TRADE OR BUSINESS.

(a) *General Rule.*—The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)), except that such term does not include any trade or business—

(1) in which substantially all the work in carrying on such trade or business is

performed for the organization without compensation; or

(2) which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 501(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

* * * * *

(c) *Advertising, Etc., Activities.*—For purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an

unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.512(a)-1. *Definition.*

* * * * *

(f) *Determination of unrelated business taxable income derived from sale of advertising in exempt organization periodicals*—(1) *In general.* Under section 513 (relating to the definition of unrelated trade or business) and § 1.513-1, amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business activity involving the exploitation of an exempt activity, namely, the circulation and readership of the periodical developed through the production and distribution of the readership content of the periodical. Paragraph (d) of this section provides for the allowance of deductions attributable to the production and distribution of the readership content of the periodical. Thus, subject to the limitations of paragraph (d)(2) of this section, where the circulation and readership of an exempt organization periodical are utilized in connection with the sale of advertising in the periodical, expenses, depreciation, and similar items of deductions attributable to the production and distribution of the editorial or readership content of the periodical shall qualify as items of deductions directly

connected with the unrelated advertising activity. Subparagraphs (2) through (6) of this paragraph provide rules for determining the amount of unrelated business taxable income attributable to the sale of advertising in exempt organization periodicals. Subparagraph (7) of this paragraph provides rules for determining when the unrelated business taxable income of two or more exempt organization periodicals may be determined on a consolidated basis.

(2) *Computation of unrelated business taxable income attributable to sale of advertising*—(i) *Excess advertising costs.* If the direct advertising costs of an exempt organization periodical (determined under subparagraph (6)(ii) of this paragraph) exceed gross advertising income (determined under subparagraph (3)(ii) of this paragraph), such excess shall be allowable as a deduction in determining unrelated business taxable income from any unrelated trade or business activity carried on by the organization.

* * * * *

(3) *Income attributable to exempt organization periodicals*—(i) *In general.* For purposes of this paragraph the total income attributable to any exempt organization periodical is the sum of its gross advertising income and is circulation income.

(ii) *Gross advertising income.* The term "gross advertising income" means all amounts derived from the unrelated advertising activities of an exempt organization periodical (or for purposes of this paragraph in the case of a taxable organization, all amounts derived from the

advertising activities of the taxable organization).

* * * * *

See subparagraph (4) of this paragraph for a discussion of the factors to be considered in determining allocable membership receipts of an exempt organization periodical under the standard described in the preceding sentence.

* * * * *

§ 1.513-1. *Definition of unrelated trade or business.*

(a) *In general.* As used in section 512 the term "unrelated business taxable income" means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the modifications provided in section 512. Section 513 specifies with certain exceptions that the phrase "unrelated trade or business" means, in the case of an organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 * * *. * * * Therefore, unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly

carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

(b) *Trade or business.* The primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete. On the other hand, where an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization sends out low-cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations. However, in general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute "trade or business" within the meaning of section 162—and which, in addition, is not substantially related to the performance of exempt functions—presents sufficient likelihood of unfair competition to be within the policy of the tax. Accordingly, for purposes of section 513 the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services. Thus, the term "trade or business" in section 513 is not limited to integrated aggre-

gates of assets, activities and good will which comprise businesses for the purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose identity as trade or business merely because the pharmacy also furnishes supplies to the hospital and patients of the hospital in accordance with its exempt purposes or in compliance with the terms of section 513(a)(2). Similarly, activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to the exempt purposes of the organization. However, where an activity carried on for the production of income constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

(c) *Regularly carried on*—(1) *General principles.* In determining whether trade or business from which a particular amount of gross income derives is "regularly carried on," within the meaning of section 512, regard must be had

to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. Hence, for example, specific business activities of an exempt organization will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

* * * * *

(d) *Substantially related*—(1) *In general.* Gross income derives from "unrelated trade or business," within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question—the activities, that is, of producing or distributing the goods or performing the service involved—and the accomplishment of the organization's exempt purposes.

(2) *Type of relationship required.* Trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is

"substantially related," for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

* * * * *

(4) *Application of principles*—(i) *Income from performance of exempt functions.* Gross income derived from charges for the performance of exempt functions does not constitute gross income from the conduct of unrelated trade or business. The following examples illustrate the application of this principle:

Example (1). M, an organization described in section 501(c)(3), operates a school for training children in the performing arts, such as acting, singing, and dancing. It presents performances by its students and derives gross income

from admission charges for the performances. The students' participation in performances before audiences is an essential part of their training. Since the income realized from the performance derives from activities which contribute importantly to the accomplishment of M's exempt purposes, it does not constitute gross income from unrelated trade or business. (For specific exclusion applicable in certain cases of contributed services, see section 513(a)(1) and paragraph (e)(1) of this section.)

Example (2). N is a trade union qualified for exemption under section 501(c)(5). To improve the trade skills of its members, N conducts refresher training courses and supplies handbooks and technical manuals. N receives payments from its members for these services and materials. However, the development and improvement of the skills of its members is one of the purposes for which exemption is granted N; and the activities described contribute importantly to that purpose. Therefore, the income derived from these activities does not constitute gross income from unrelated trade or business.

Example (3). O is an industry trade association qualified for exemption under section 501(c)(6). It presents a trade show in which members of its industry join in an exhibition of industry products. O derives income from charges made to exhibitors for exhibit space and admission fees charged patrons or viewers of the show. The show is not a sales facility for individual exhibitors; its purpose is the promotion and stimulation of interest in, and demand for, the industry's products in general, and it is con-

ducted in a manner reasonably calculated to achieve that purpose. The stimulation of demand for the industry's products in general is one of the purposes for which exemption is granted O. Consequently, the activities productive of O's gross income from the show—that is, the promotion, organization and conduct of the exhibition—contribute importantly to the achievement of an exempt purpose, and the income does not constitute gross income from unrelated trade or business.

* * * * *

(iv) *Exploitation of exempt functions.* In certain cases, activities carried on by an organization in the performance of exempt functions may generate good will or other intangibles which are capable of being exploited in commercial endeavors. Where an organization exploits such an intangible in commercial activities, the mere fact that the resultant income depends in part upon an exempt function of the organization does not make it gross income from related trade or business. In such cases, unless the commercial activities themselves contribute importantly to the accomplishment of an exempt purpose, the income which they produce is gross income from the conduct of unrelated trade or business. The application of this subdivision is illustrated in the following examples:

* * * * *

Example (5). Y, an exempt university, provides facilities, instruction and faculty supervision for a campus newspaper operated by its students. In addition to news items and editorial

commentary, the newspaper publishes paid advertising. The solicitation, sale, and publication of the advertising are conducted by students, under the supervision and instruction of the university. Although the services rendered to advertisers are of a commercial character, the advertising business contributes importantly to the university's educational program through the training of the students involved. Hence, none of the income derived from publication of the newspaper constitutes gross income from unrelated trade or business. The same result would follow even though the newspaper is published by a separately incorporated section 501(c)(3) organization, qualified under the university rules for recognition of student activities, and even though such organization utilizes its own facilities and is independent of faculty supervision, but carries out its educational purposes by means of student instruction of other students in the editorial and advertising activities and student participation in those activities.

Example (6). Z is an association exempt under section 501(c)(6), formed to advance the interests of a particular profession and drawing its membership from the members of that profession. Z publishes a monthly journal containing articles and other editorial material which contribute importantly to the accomplishment of purposes for which exemption is granted the organization. Income from the sale of subscriptions to members and others in accordance with the organization's exempt purposes, therefore, does not constitute gross income from unrelated trade or business. In connection with the publi-

cation of the journal, Z also derives income from the regular sale of space and services for general consumer advertising, including advertising of such products as soft drinks, automobiles, articles of apparel, and home appliances. Neither the publication of such advertisements nor the performance of services for such commercial advertisers contributes importantly to the accomplishment of any purpose for which exemption is granted. Therefore, notwithstanding the fact that the production of income from advertising utilizes the circulation developed and maintained in performance of exempt functions, such income is gross income from unrelated trade or business.

Example (7). The facts are as described in the preceding example, except that the advertising in Z's journal promotes only products which are within the general area of professional interest of its members. Following a practice common among taxable magazines which publish advertiisng, Z requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, Z accepts advertising only from those who are willing to pay its prescribed

rates. Although continuing education of its members in matters pertaining to their profession is one of the purposes for which Z is granted exemption, the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute; it differs fundamentally from such an activity both in its governing objective and in its method. Accordingly, Z's publication of advertising does not contribute importantly to the accomplishment of its exempt purposes; and the income which it derives from advertising constitutes gross income from unrelated trade or business.

(e) *Exceptions.* Section 513(a) specifically states that the term "unrelated trade or business" does not include—

(1) Any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) Any trade or business carried on by an organization described in section 501(c)(3) or by a governmental college or university described in section 511(a)(2)(B), primarily for the convenience of its members, students, patients, officers, or employees; or, any trade or business carried on by a local association of employees described in section 501(c)(4) organized before May 27, 1969, which consists of the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

(3) Any trade or business which consists of selling merchandise, substantially all of which has been received by the organization as gifts or contributions.

An example of the operation of the first of the exceptions mentioned above would be an exempt orphanage operating a retail store and selling to the general public, where substantially all the work in carrying on such business is performed for the organization by volunteers without compensation. An example of the first part of the second exception, relating to an organization described in section 501(c)(3) or a governmental college or university described in section 511 (a)(2)(B), would be a laundry operated by a college for the purpose of laundering dormitory linens and the clothing of students. The latter part of the second exception, dealing with certain sales by local employee associations, will not apply to sales of these items at locations other than the usual place of employment of the employees; therefore sales at such other locations will continue to be treated as unrelated trade or business. The third exception applies to so-called "thrift shops" operated by a tax-exempt organization where those desiring to benefit such organization contribute old clothes, books, furniture, et cetera, to be sold to the general public with the proceeds going to the exempt organization.

* * * * *

APPENDIX G

The advertisements reproduced on the following pages appeared in the January 1975 issue of *Annals of Internal Medicine* (at pages I39, I41, and I48-I49, respectively), and in the February 1975 issue of *Annals of Internal Medicine* (at pages I31, I33, I53, and I86, respectively).

EDITOR'S NOTE

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Insulin	U-20	1923
Insulin	U-40	1925
Insulin	U-80	1925
Regular Insulin	U-80	1926
Protamine Zinc Insulin	U-40	1937
Protamine Zinc Insulin	U-80	1938
NPH Insulin	U-40	1950
NPH Insulin	U-80	1950
Regular Insulin	U-500	1952
Lente® Insulin	U-40	1954
Lente® Insulin	U-80	1954
Semilente® Insulin	U-40	1957
Semilente® Insulin	U-80	1957
Ultralente® Insulin	U-40	1957
Ultralente® Insulin	U-80	1957
Regular Insulin	U-100	1973
NPH Insulin	U-100	1973
Protamine Zinc Insulin	U-100	1973
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CLASSIFIED ADVERTISING RATES

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Minimum number of lines - 3
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Rate per line, **one time** - $4.00
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Rate per line, **three times** - $3.70
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BOX NUMBER - $1.50 per insertion
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***NOTE:** Special layouts may require additional charges (unless camera ready copy is provided).

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Rate per column inch, **two times** - $55.00 (plus $6.00 ea. add. line)
Rate per column inch, **three to five times** - $50 (plus $5.50 ea. add. line)
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INTERNISTS—40 Physicians multispecialty clinic seeks 2 Internists with specialty training in gastroenterology and pulmonary diseases. Salary two years, then partnership. Contact Medical Director, Billings Clinic, Box 2555, Billings, Montana 59103. P6Ja2x

CARDIOLOGIST: 35, Asst. Prof. Med., ABIM, Expertise Intensive Care/Cardiac Cath. Desires position Med. School, Affiliated Hospital or Academic Group. Address: Box 174, AIM. P11Ja2z

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The NYC Dept. of Health seeks a capable administrator to assume the responsibility of Assistant Commissioner for Communicable & Chronic Disease Services.
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GASTROENTEROLOGIST, 32, A.B.I.M., univ. trained in all endoscopic procedures with additional liver disease experience. Seeks hospital based or group practice in So. Calif. or Ariz. Available July, '75. Box 173, AIM. P10Ja6x

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INTERNIST-CHEST PHYSICIAN, 29, ABIM cert., trained in fiberoptic bronchoscopy, intensive resp. care, & pulm. func. test. Available July 1975. Box 178, AIM. P18Ja1x

DIRECTOR OF MEDICAL EDUCATION for 500-bed community teaching hospital, coastal city on Great Lakes. Center approved for training in wide range of clinical specialties. Hospital has educational atmosphere with interested educational coordinators in each clinical dept. Applicant will be challenged to develop a top-notch organization-wide program. Good educational background, knowledge of med. education techniques, interest in all fields of med., a high degree of communications skills, and a managerial attitude required. Minimum related experience acceptable. Substantial salary with growth potential plus good benefit program. Send C.V. in confidence to Arthur A. Lepinot, Hosp. & Med. Planning, Inc., 702 Abbott Rd., East Lansing, Mi 48823. P25Ja1x

INTERNIST-GASTROENT., 34, Univ. trained, board eligible. Recently finished G.I. fellowship. Extensive experience in endoscopy. Seeks group practice in New England, S.F., or Mpls. Box 179, AIM. P19Ja1x

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PULMONARY: 2 hospital-based pulmonary physicians seek associate in university affiliated community hospital with Pulmonary Fellowship Program. Liberal starting salary leading to partnership. Oceanside living. Forward CV to Arthur F. Gelb, M.D., or Robert Lugliani, M.D., Pulmonary Disease Institute, a medical group, 1045 Atlantic Avenue, Suite 902, Long Beach, CA 90813. P23Ja3x

MEDICAL ONCOLOGIST. Multispecialty Group in midwest seeks to expand Oncology Dept. Interested parties send CV to Box 183, AIM. P24Ja1x

GASTROENTEROLOGIST, ABIM, all Univ. trained, Extensive endoscopy and motility exper. Avail. July, 75. Seek hospital-based or group practice in Northeast. Box 184, AIM. P26Ja1x

GASTROENTEROLOGIST, 31, ABIM, univ. trained, exper. endoscopy, colonoscopy, desires GI position Wash., D.C. area., N.Y., N.J., Conn., Fla. only. Available 7/75. Box 180, AIM P20Ja1x

GENERAL INTERNIST, university-trained, age 30, board eligible, military service completed, seeks position with small group for July, 1975. Southern New England or Northeast preferred. Write Box 181, AIM. P21Ja2x

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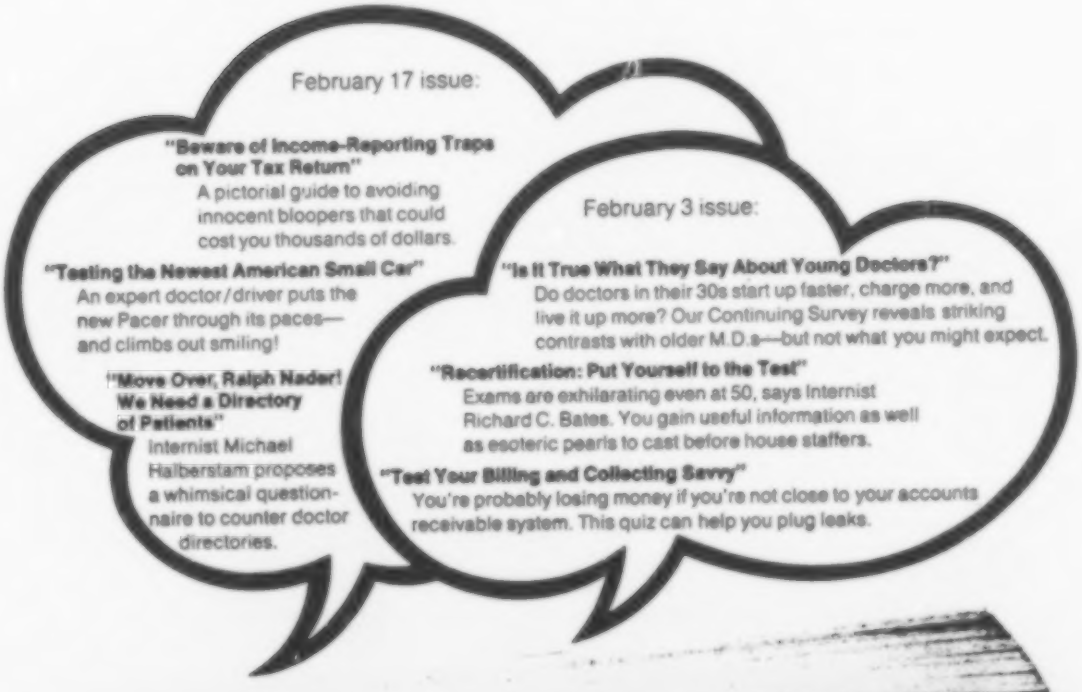

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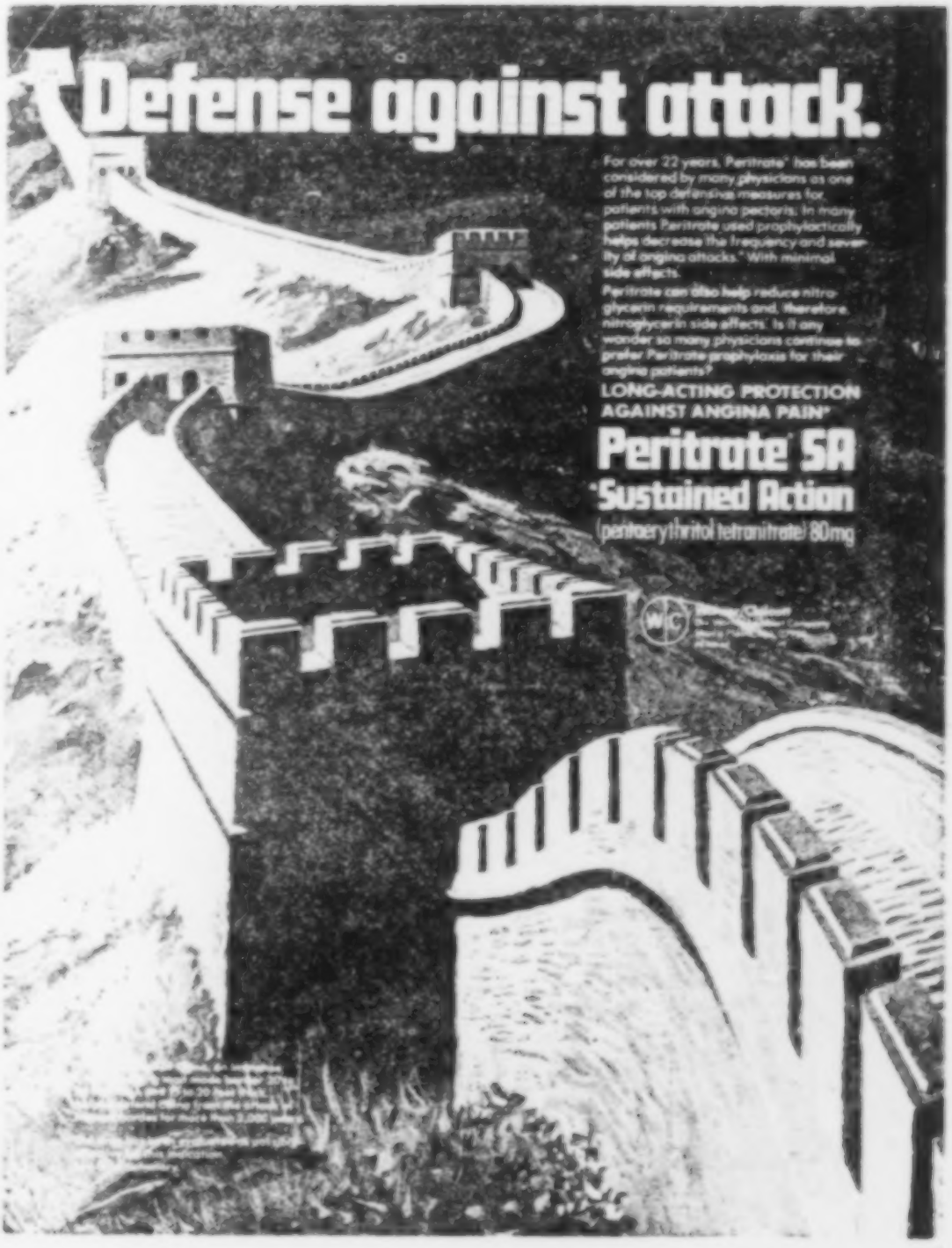
Because all support hosiery is not alike
Parke, Davis & Company, Detroit, Michigan 48232

Darvocet-N 100
Lilly

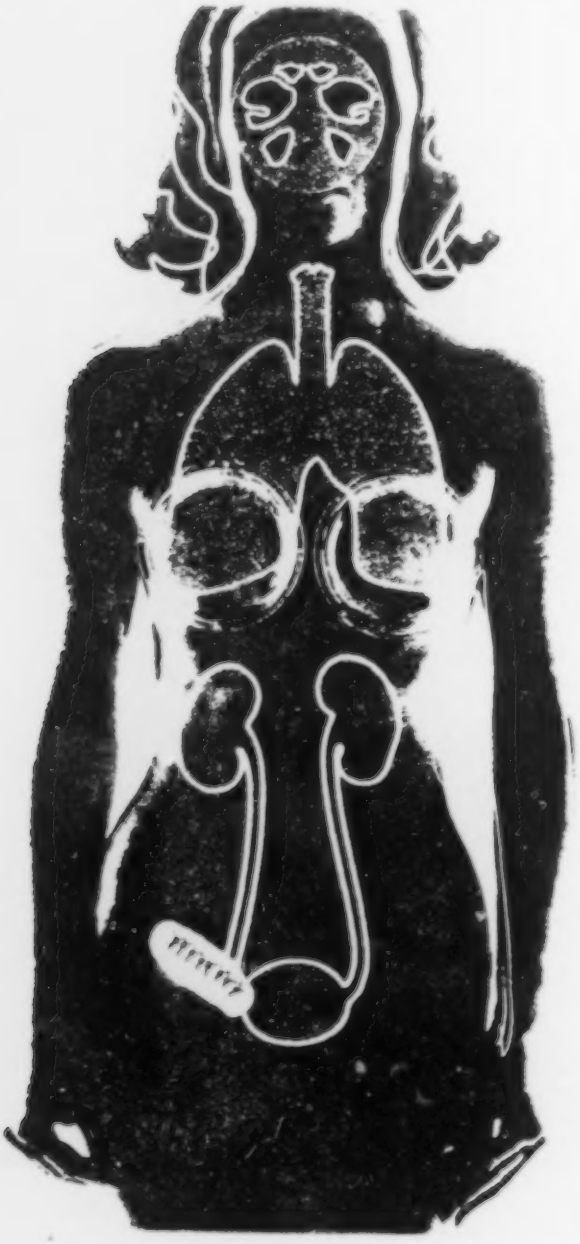
APPENDIX H

The advertisements reproduced on the following pages appeared in the February 1975 issue of *Annals of Internal Medicine* (at pages I59, I50, and I46-I47, respectively).

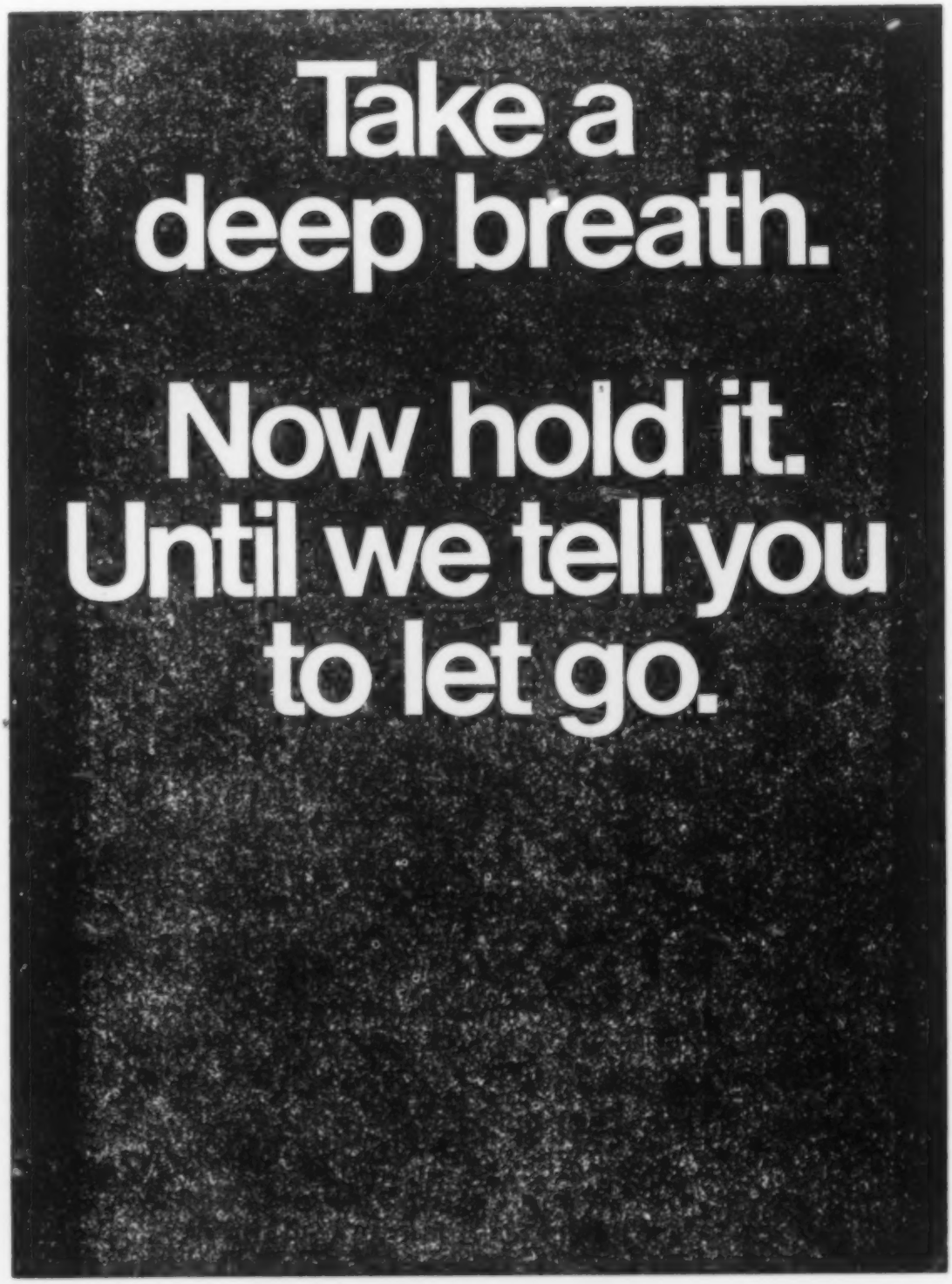

Defense against attack.
For over 22 years, Peritrate® has been considered by many physicians as one of the top defensive measures for patients with angina pectoris. In many patients Peritrate used prophylactically helps decrease the frequency and severity of angina attacks.* With minimal side effects.
Peritrate can also help reduce nitroglycerin requirements and, therefore, nitroglycerin side effects. Is it any wonder so many physicians continue to prefer Peritrate prophylaxis for their angina patients?
LONG-ACTING PROTECTION AGAINST ANGINA PAIN*
Peritrate® SA
*Sustained Action
(pentaerythritol tetranitrate) 80mg

New
from
SK&F

ANSPOR
BRAND OF
CEPHRADINE
capsules: 250 and 500 mg
for oral suspension: 125 and 250 mg./5 ml.



SK&F
SMITH KLINE
& FRENCH
LABORATORIES


Take a
deep breath.
Now hold it.
Until we tell you
to let go.

"This sensation of air hunger [has] both intensity and quality...the length of time that the breath can be held depends upon P_{CO_2}, P_{O_2}, pH, lung volume, level of physical activity, prior hyperventilation, level of CO_2 acclimatization (tolerance), motivation and self discipline."*

Okay. Exhale.

You've just experienced air hunger. It is only an intimation of what your patients with reversible bronchospasm may experience. You rarely think about breathing. They rarely stop thinking about it.

Alupent® (metaproterenol sulfate). It can help take your bronchial asthmatic's mind off his lungs by relieving reversible bronchospasm.

Alupent. The first single-entity bronchodilator effective in both tablet and aerosol dosage form.

Alupent®
(metaproterenol sulfate)
Tablets and Metered Dose Inhaler

Please see next page for brief summary of the prescribing information

*Slonim, N. Balfour and Hamilton, Lyle H., *Respiratory Physiology*, St. Louis, The C.V. Mosby Company, 1971, ed 2, pp 136-137

A83

APPENDIX I

The advertisements reproduced on the following pages appeared in the February 1975 issue of *The American Journal of Medicine* (at pages A85, A108, and A40-A41 respectively). *The American Journal of Medicine* is published by a division of Dun and Bradstreet, a taxable commercial publisher.

Defense against attack.
For over 22 years, Peritrate® has been considered by many physicians as one of the top defensive measures for patients with angina pectoris. In many patients Peritrate used prophylactically helps decrease the frequency and severity of angina attacks.* With minimal side effects.
Peritrate can also help reduce nitroglycerin requirements and, therefore, nitroglycerin side effects. Is it any wonder so many physicians continue to prefer Peritrate prophylaxis for their angina patients?
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Peritrate SA
Sustained Action
(pentaerythritol tetranitrate) 80mg
Warner/Chilcott

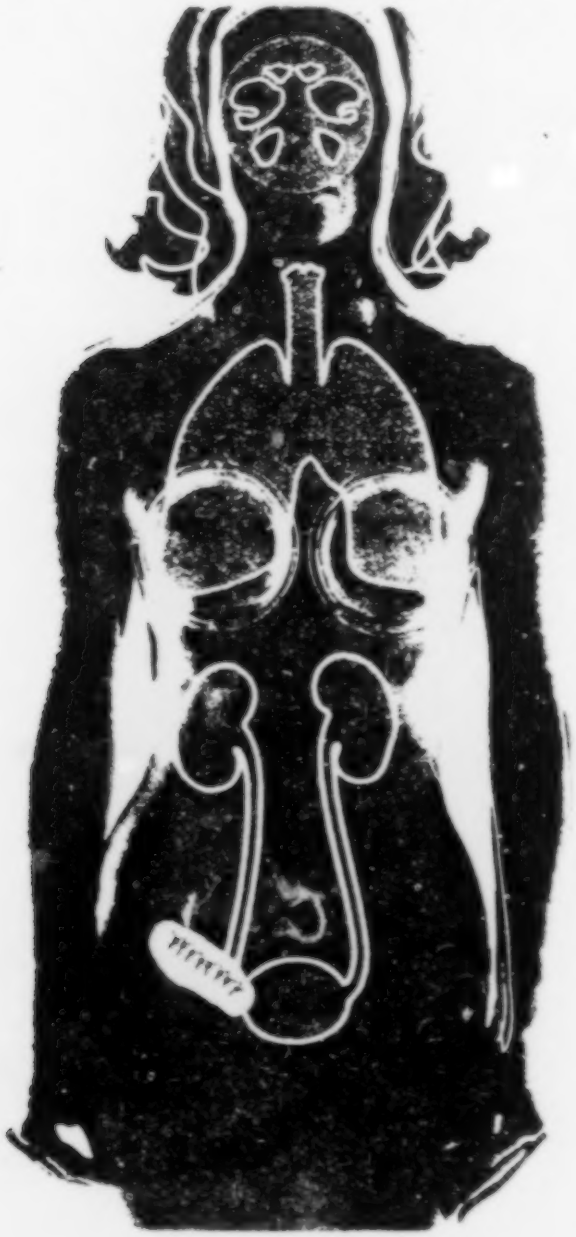
New
from
SK&F

ANSPOR

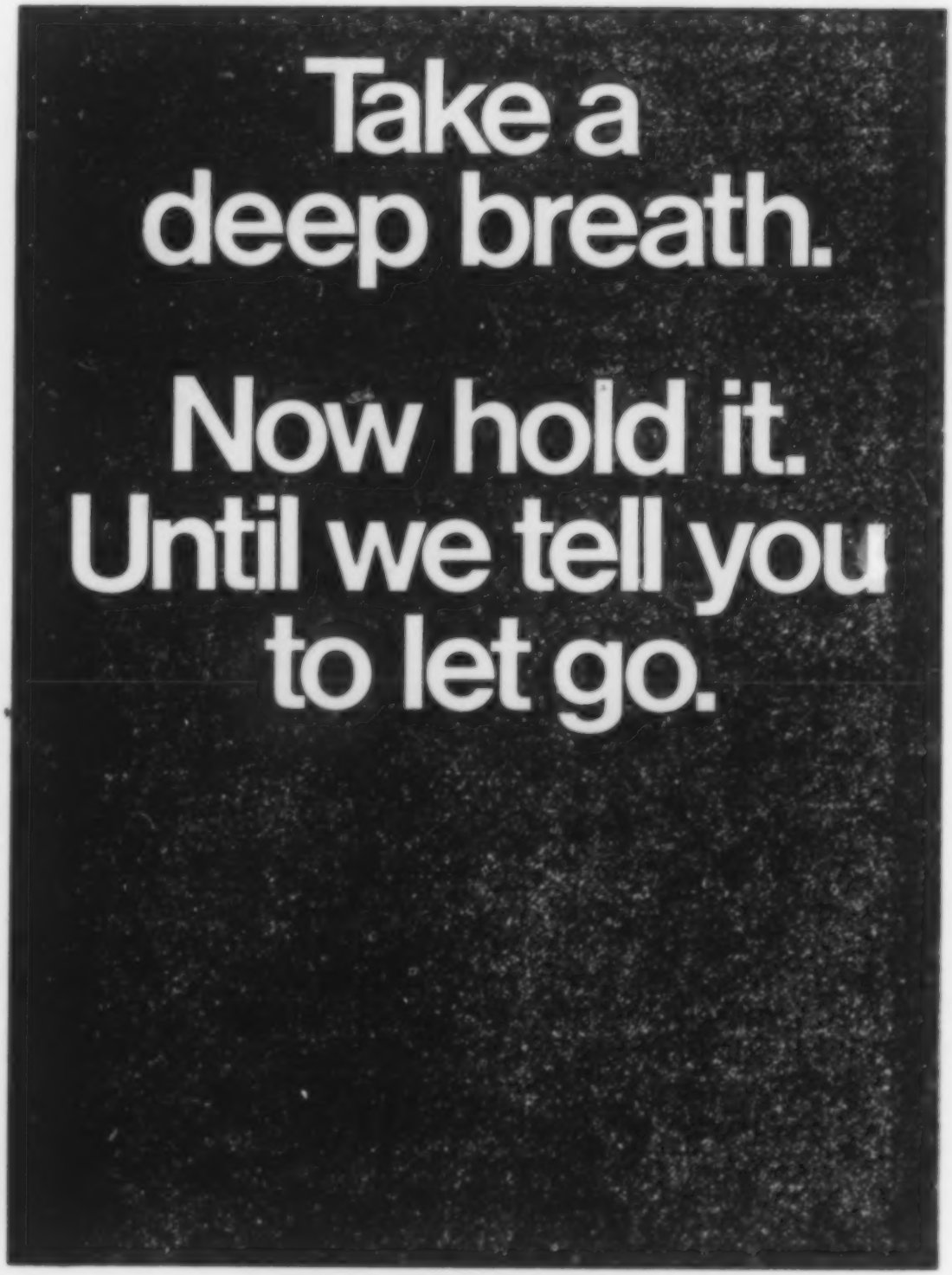
BRAND OF

CEPHRADINE

capsules: 250 and 500 mg.
for oral suspension: 125 and 250 mg./5 ml.



SK&F
SMITH KLINE
& FRENCH
LABORATORIES


Take a
deep breath.
Now hold it.
Until we tell you
to let go.

"This sensation of air hunger [has] both intensity and quality...the length of time that the breath can be held depends upon P_{CO_2}, P_{O_2}, pH, lung volume, level of physical activity, prior hyperventilation, level of CO_2 acclimatization (tolerance), motivation and self discipline."*

Okay. Exhale.

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AB

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No. 84-1737

Office-Supreme Court, U.S.
FILED
JUN 6 1985
ALEXANDER L. STEVAS,
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1984

UNITED STATES OF AMERICA
Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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*Counsel of Record for Respondent Upon Whom Service Is To Be Made

PACKARD PRESS / LEGAL DIVISION, 10th & SPRING GARDEN STREETS, PHILA., PA. 19123 (215) 236-2900

Question Presented

The Internal Revenue Code and Regulations impose a tax on the "unrelated business income" that an otherwise tax-exempt organization receives from trade or business activities which are not "substantially related" to, *i.e.* do not "contribute importantly" to, the performance of its educational functions constituting the basis for its exemption. The question presented is:

Whether on the record in this case the court of appeals properly held that advertisements in the scholarly journal of a medical association, organized and exempt for charitable and educational purposes pursuant to Section 501(c)(3) of the Code, which relate solely to the practice of internal medicine, are "substantially related" and "contribute importantly" to the tax-exempt purposes of that organization and thus are not subject to the unrelated business income tax.

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No. 84-1737

IN THE

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October Term, 1984

UNITED STATES OF AMERICA

Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

This case involves the taxation of advertising income of organizations otherwise exempt from taxation under the Internal Revenue Code. The issue is best understood in the context of the history of the relevant Code provisions and the implementing regulations of the Internal Revenue Service ("IRS"). Section 501 of the Code defines 23 categories of organizations that are exempt from taxation, in accordance with the purposes for which they are organized. Of particular relevance here are two subsections: (c)(3), covering organizations formed and operated exclusively for charitable, scientific, educational and like purposes, and (c)(6), covering business leagues,

chambers of commerce, real estate boards, boards of trade and professional football leagues.[1]

In the Revenue Act of 1950, Congress enacted provisions subjecting to taxation the income of an exempt organization received from any "unrelated trade or business" it regularly carried on.[2] IRC §§511(a), 512(a). In Section 513(a) Congress defined an "unrelated trade or business" as

> any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

As to several specified categories of organizations, including those exempt under subsection (c)(3) but not subsection (c)(6), Congress also provided that such income would nevertheless not be taxable if the trade or business of the organization was carried on "primarily for the convenience of its members, students, patients, officers, or employees." §513(a)(2).

Respondent American College of Physicians ("the College") is an association exempt from tax pursuant to

---

1. In addition to differences in purpose, (c)(3) organizations, unlike (c)(6) organizations, are limited with respect to political activity and lobbying. §501(c)(3).

2. Prior to the 1950 legislation, all income received by tax-exempt organizations was free of tax. In response to certain situations where exempt organizations were receiving income from wholly unrelated businesses, Congress enacted the 1950 amendments in an effort to tax such income. "The 1950 Act was a fairly limited measure, designed to distinguish the customary activities of exempt organizations from the operation of independent business enterprises entirely unrelated to" the purpose of the organization justifying exempt status. *American College of Physicians v. United States*, 530 F.2d 930, 933 (Ct. Cl. 1976). *Accord, Massachusetts Medical Soc'y v. United States*, 514 F.2d 153, 155 (1st Cir. 1975). As the court noted in *American College*, "[t]he publication of advertising in tax-exempt educational journals was a well-established practice before 1950." 530 F.2d at 933.

Section 501(c)(3). As stated in its Articles of Incorporation, the College's tax-exempt purposes are, *inter alia*, (1) to uphold and to maintain high standards in medical education and medical practice; (2) to encourage research, especially in clinical medicine; and (3) to foster measures for the prevention of disease and for the improvement of public health (C.A. App. 19A). Its members consist solely of members of the medical profession engaged in practice, teaching, research or other pursuits in the field of internal medicine or in allied or related specialties. In 1975, the College had approximately 32,000 members. (C.A. App. 19A).

In furtherance of its exempt purposes, the College publishes *Annals of Internal Medicine* ("*Annals*"), sponsors a comprehensive annual post-graduate session, international and regional educational programs, and offers post-graduate continuing education for physicians. (C.A. App. 19A, 26A-28A). *Annals* contains scholarly articles relevant to the practice of internal medicine and is one of the most highly regarded medical journals in the field of internal medicine in the world. (C.A. App. 19A). *Annals* is provided to the College's members without charge other than dues, is available to non-members on a per-issue basis or by subscription, and is circulated in medical schools and in medical and non-medical libraries throughout the world. Its circulation in 1975 was roughly 73,000. (C.A. App. 19A).

Each monthly issue of *Annals* contains advertisements relating solely to medical products, supplies and equipment useful in the practice of internal medicine, and notices of positions available in connection with the practice of internal medicine.[3] Approximately eighty per-

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3. Beginning in 1975, *Annals* began to accept a small amount of classified advertising, similarly restricted to advertisements directly relevant to the practice of medicine. Typical categories of such advertising include notices of available positions, announcements of

cent of these advertisements are for prescription drugs,[4] and contain extensive information mandated by the Federal Food and Drug Administration ("FDA") concerning the use, indications and contraindications for, known adverse reactions to, and recommended dosage of each such product. (C.A. App. 20A, 35A; *see* p. 17 n. 24 & App. B, *infra*).[5] The College has a long-standing policy of accepting only those advertisements which meet these restrictions, and screens each proferred advertisement for accuracy and relevance to internal medicine. The College has rejected advertisements which have not conformed with its policy because of the type of products advertised or the inadequacy of information contained in the advertisements. (C.A. App. 20A).

The advertisements published in *Annals* are concentrated in two sections to the front and rear of the editorial copy, and are indexed. (C.A. App. 20A). The College sets advertising rates by reference to its costs and the need to be competitive with rates set by other medical journals. (C.A. App. 22A).[6]

NOTES *(Continued)*

postgraduate courses and symposia, notices of medical equipment or facilities for sale or rent, and notices of medical books and journals wanted or for sale.

4. For example, advertising in the January 1975 issue of *Annals* (Exhibit P-1 in the Claims Court) can be broken down into the following categories, calculated according to column-inch:

Prescription Drugs	80%
Medical Books	6%
Medical Classified	3%
Non-Prescription Drugs	6%
Medical Instruments	3%
Continuing Medical Education	2%

Thus, the government's characterization of the advertising in *Annals* as "the garden variety commercial type" (Pet. 20) is scarcely apt here.

5. Federal Food, Drug & Cosmetic Act, 21 U.S.C. §352(n). (1982).

6. Not surprisingly, given the FDA's role, the nature of the products advertised, and the audience involved, in some instances

Prior to 1967 the government made no effort to contend that income from advertising in a publication of a (c)(3) organization such as *Annals* was taxable, and the College did not pay taxes on such income. In 1967, however, the IRS revised its regulations implementing Section 513. In a principal — and controversial — change, the new regulations provided for the fragmentation of activities of an exempt organization so that each activity, such as the publication of advertising, had to be assessed separately to see if it constituted an unrelated trade or business. §1.513-1(b). The regulations provided that whether a trade or business activity was "substantially related" would turn on the existence of a substantial causal relationship to the achievement of exempt purposes, which would be so where the activity "contribute[s] importantly to the accomplishment of those purposes." §1.513-1(d)(2). The regulations further provided that

> [w]hether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved. [*Id.*][7]

Finally, the regulations set forth several "examples" illustrating the application of these principles. §1.513-1(d)(4). Example 5 addresses advertising in pub-

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the advertisements appearing in *Annals*, which are prepared by the advertisers, are identical to advertisements appearing in medical journals published by non-exempt organizations, such as the *American Journal of Medicine* and the *American Journal of Cardiology*. (C.A. App. 21A). The record does not reveal the extent to which this is the case.

7. The case-by-case approach of the regulations is also reflected in a provision that, if an activity is related in part to the performance of exempt functions but conducted on a larger scale than is reasonably necessary, income attributable to the excess activity is taxable. §1.513-1(d)(3). This provision, omitted from the Petition Appendix, is set forth at Appendix A *infra*.

lications of universities and other (c)(3) organizations and presents some circumstances where advertising income would not be taxable. As finally promulgated,[8] Examples 6 and 7 address publications of organizations exempt under (c)(6) and indicate circumstances where advertising income would be taxable.

Although the regulations thus did not purport to set forth a rule under which all advertising income of all exempt organizations would be deemed *per se* "unrelated" and hence taxable,[9] the fragmentation provision compelled that result as a practical matter for the many organizations (such as trade associations exempt under (c)(6)) which would not be able to show that the advertising they published contributed importantly to their exempt purpose. The resulting controversy over the validity of the fragmentation rule led to Congressional action in the Tax Reform Act of 1969.

In that Act, Congress added Section 513(c), expressly endorsing the fragmentation principle of the regulations. The statute did not otherwise address how advertising (or any other activity) of any type of exempt organization should be treated;[10] nor did it alter the factually-oriented, case-by-case approach expressly required by the regulations.

As the 1969 Act only applied prospectively, the validity of the fragmentation approach was still in issue as

8. *See* pp. 12-13 *infra*.

9. In §1.512(a)-1(f), concerning the computation and attribution of income, the regulations state generally that amounts realized from advertising in a periodical constitute income from an unrelated trade or business activity, but that section did not purport to define such income and was instead merely referring to income which was determined to be taxable under Section 513 and §1.513-1.

10. The government erroneously asserts that the statute specifically addresses "an activity, such as advertising." (Pet. 4). The *only* reference to advertising is in the title to section 513(c) ("Advertising, Etc., Activities"), to which the government repeatedly refers (Pet. 4, 7, 14), but subsection titles do not constitute law. IRC §7806(b).

to prior tax years, and the College was among the taxpayers who successfully challenged the regulation in that respect. In *American College of Physicians v. United States*, 530 F.2d 930 (Ct. Cl. 1976) ("*ACP I*"), the court held that the fragmentation regulation was invalid. The court therefore found it unnecessary to reach the College's alternative contention that the advertising in *Annals* "contribute[d] importantly" to and hence was "substantially related" to the purposes underlying the College's exemption as a (c)(3) organization. However, the court effectively determined the parameters of the instant litigation by holding that the issue of the relatedness of the advertising was an "essentially factual dispute." *Id.* at 931 n.3.

The present case arose when the College unsuccessfully sought a refund for taxes paid on the income from its publications during taxable year 1975. In the Claims Court, the government did not seek summary judgment, as would have been warranted under the *per se* rule now advocated by the Solicitor General. Rather, as required by the holding in *ACP I*, both sides treated the issue as "essentially factual." The case was tried upon a factual stipulation, documentary evidence, and testimony concerning the relationship between the advertising in *Annals* and the purposes underlying the College's exemption under Section 501(c)(3).

The College presented unrebutted testimony that the inclusion of advertising pursuant to the strict limitations of the College's policy is a key means of alerting practicing internists of the availability of new drugs and developments relating to already established drugs, and that being current with respect to available drugs and their properties is vital for the internist, thereby disseminating improvements in available treatment and raising the standard of medical care available to the physicians'

patients.[11] Each of the four witnesses presented unrebutted testimony that the advertising published in *Annals* "contribute[d] importantly" to these exempt functions.

Following trial, the Claims Court denied the petition. The Court based its decision upon a factual analysis of that relationship and concluded that the advertising had a predominantly commercial purpose that precluded it from contributing importantly to the purposes underlying the College's exemption under Section 501(c)(3). (Pet. App. 28a).[12]

On the College's appeal, the government contended that "the Statute and Regulations require a factual inquiry into the activity, and its relationship to exempt functions," that "the Claims Court conducted the required inquiry into the facts and circumstances involved," and that it "cannot be doubted that the question involved here is one of fact."[13] Similarly, in an amicus brief in support of the government's unsuccess-

11. According to the 1977 policy statement incompletely quoted by the government (Pet. 4):

> [d]rug advertisements in peer-review journals are a vital part of continuing pharmacologic education. [I]t does serve an alerting function: to provoke the physician's interest to the extent that he will look further into the drug's use by reading a contemporary pharmacology text, or ask his librarian to reproduce a few recent references from current journals, or look it up in *The Medical Letter* or *AMA Drug Evaluations*. This catching of the reader's attention is a short but important step down the track of education on drug use to more enlightened prescribing. [C.A. App. 71A].

Compare Zauderer v. Office of Disciplinary Counsel, 53 U.S.L.W. 4587, 4593 (U.S. May 28, 1985) (noting "important" attention-getting and communicative functions of illustrated advertisements for professional services).

12. Prior to 1967, the Regulations contained a "primary purpose" test, but this was replaced that year by the "contribute importantly" language. *See* T.D. 6301, 1958-2 C.B. 197, *superseded by* T.D. 6939, 1968-1 C.B. 274.

13. Brief for Appellee, pp. 3, 8, 9.

ful petition for rehearing, American Business Press emphasized that the case had been treated at trial and on appeal as "a factual dispute."[14] The College agreed that the issue was factual, and turned on the relationship between the advertising and its exempt purpose as a (c)(3) organization.[15] The College did not challenge the validity of Example 7, but argued that it was distinguishable.

The court of appeals agreed with both parties that the issue was factual. It held, however, that the Claims Court's resolution of that issue was "clearly erroneous" because it improperly gave undue weight to whether the advertising was "commercial" in nature. (Pet. App. 16a-17a). The court of appeals held that, on the record in this case, the advertising in *Annals* was shown by the College to contribute importantly to the educational purposes underlying its exemption under Section 501(c)(3). (Pet. App. 19a). The court was also unpersuaded by the argument that the legislative history of the 1969 amendment showed clearly that Congress intended to tax all advertising income in publications of all exempt organizations, and held that in any event the language of the statute did not do so. (Pet. App. 12a).

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14. Amicus Curiae Brief of American Business Press in Support of Appellee's Suggestion for Rehearing En Banc, p. 2.

15. The government did not disagree, and stated:

> In any situation in which a determination must be made as to whether a particular business activity "contributes importantly" to the exempt function of an organization, the court must first clearly identify the purposes of the organization, and then carefully inquire into how one or more of those purposes is promoted by the business activity. Since a business league is a different type of exempt organization, with a different kind of exempt function, analysis of how a business activity is directly related will naturally differ from the same inquiry involving a different organization, such as a hospital, with different exempt functions. [Brief for Appellee, p. 19.]

REASONS FOR REFUSING THE PETITION

Contrary to the government's Petition, the case before this Court was correctly decided on a narrow factual basis which will preclude more than a handful of organizations exempt from tax pursuant to Section 501(c)(3) from successfully claiming that their advertising income is not subject to any unrelated business income tax. The administrative burden resulting from the decision should be slight. The decision below did not misconstrue the applicable Code sections or Treasury regulations, but merely applied them as written. This construction admittedly does not present a conflict among the circuits requiring resolution by this Court. Thus, no "special and important" reasons exist to support issuance of the writ. Sup. Ct. Rule 17.1.

A. This Case Does Not Present the Question the Petition Asks the Court to Review, and the Court of Appeals Correctly Decided the Only Question Before It.

The government is urging a construction of Section 513 of the Internal Revenue Code which would establish a *per se* rule declaring revenue realized by a tax-exempt organization from the sale of advertising in its journals to be taxable as a matter of law, without regard to the facts of a particular case. The government describes this case as presenting a necessary choice between this *per se* rule (or perhaps an undefined presumption)[16] and what it describes as a novel, subjective, "case-by-case, ad-by-ad" approach entailing *sub silentio* invalidation of Example 7 in the regulations. Neither this choice nor even the issue of a *per se* rule is properly presented here. For several reasons, this case is a uniquely inappropriate vehicle for

16. The government's position is not entirely clear as to whether it contends for a "per se" rule or a "presumption" and, if the latter, what is its content and whether or how it may be rebutted. (Pet. 18, 19). This vagueness is an additional consideration making review unwarranted in this case.

considering the question whether Section 513(c) or Example 7 establishes a *per se* rule making income from advertising in publications of virtually all exempt organizations taxable.

1. In accordance with the Court's decision in *ACP I*, this case was litigated by both the College and the Government as presenting a factual question to be decided on the evidentiary record concerning the relationship between the advertisements in *Annals* and the charitable and educational purposes underlying the College's exemption as a (c)(3) organization. Having argued below that the case was correctly tried and decided as presenting a factual issue — as required by *ACP I* — the government cannot now argue that the case instead presents a legal issue concerning the application of a *per se* rule.[17] The government's contention for a *per se* rule can be considered more appropriately in a case where there was not a prior determination as to the factual nature of the issue and the parties did not litigate it as a factual issue.

2. The decision of the court below simply corrected the trial court's clearly erroneous factual analysis of the relationship between the advertising which appears in *Annals* and exempt purposes of the College. In an effort to transform this into a significant tax issue worthy of this Court's consideration, the government mischaracterizes the court of appeal's decision as an invalidation *sub silentio* of Example 7 in the regulations, which states that income from commercial advertising solicited by a (c)(6) organization for inclusion in a journal published by such an organization, even though limited to "products which are within the general area of profes-

17. It would be contrary to the interests of judicial economy — and unfair to litigants such as the College — if the government were permitted to reframe the litigation in the Supreme Court in an effort to present a question of law rather than of fact after endorsing the propriety of a trial, which under the government's position in this Court would have been impermissible. *See* p. 8 *supra*.

sional interests of its members," is taxable. (Pet. 8, 21-22). While it is true that the court of appeals did not discuss the validity *vel non* of Example 7, this silence is perfectly understandable because the College never challenged Example 7. It expressly waived that argument, and instead contended that Example 7 was inapplicable to a (c)(3) organization.[18] Because of the differences in purposes underlying organizations that are tax-exempt pursuant to Section 501(c)(6) — business leagues, chambers of commerce, or similar organizations formed to advance the financial interests of the particular businesses from which their memberships are drawn — and the charitable or educational functions of a (c)(3) organization such as the College, the IRS may plausibly contend that Example 7 is a shorthand determination that advertising will not have a "substantial relationship" to an exempt purpose for a (c)(6) organization (to which Example 7 was deliberately limited). The same cannot be said for a (c)(3) organization, as indicated by Example 5.

The Examples to Treasury Reg. §1.513-1(d)(4) further reflect that where they were intended to apply to all exempt organizations, no specific designation is included. Of the 79 examples in the Regulations governing the unrelated business income tax, 15 refer to specific paragraphs in Section 501(c) and 16 make general references to "exempt organizations." The remainder refer specifically to a particular type of organization (*e.g.*, "hospital," "trade association," "university"). When the Regulations originally were proposed in 1967, they did not contain Example 7 and Example 6, which provides the context for Example 7, referred only to an "exempt trade organization." 32 Fed. Reg. 5995 (1967). When the Regulations were promulgated in final form, the refer-

18. Brief for Appellant, pp. 28-31. This waiver of a challenge to the validity of Example 7 was further emphasized in the oral argument. The full text of Example 7 is contained in the Government's Petition. (Pet. App. 52a-53a).

ence to "an association exempt under Section 501(c)(6)" was inserted in Example 6 and Example 7 was added in its present form, referring to associations covered by Example 6. The specific reference in Examples 6 and 7 to a 501(c)(6) organization, therefore, is not random or without significance.

The court of appeals obviously agreed that Example 7 was inapplicable. Thus, the issue of the validity of Example 7 simply does not arise in this case.[19]

The court of appeals held that the College was entitled to prove that the advertising in *Annals* contributed importantly to the educational purposes underlying the College's exemption as a (c)(3) organization, and that it had made such a showing. That ruling was consistent with Section 513 and the regulations, as demonstrated above.

The government's argument to the contrary rests largely on statements in the legislative history by opponents to the 1969 amendment in which Congress adopted the "fragmentation" language in Section 513(c). As noted above, the 1969 amendments left wholly unchanged the "substantial relationship" test, nowhere stated the *per se* rule which the government now advances, and did not alter the regulations providing that whether advertising or any other activity "contribute[s] importantly" to an organization's exempt purpose

19. Despite the government's protestations that Example 7 has been judicially overruled and that the revenue results will be substantial, the IRS, through Howard Schoenfeld, special assistant for exempt-organization matters, recently told a briefing sponsored by the American Association of Association Executives that the case was "a factually narrow dispute that is not of as much benefit to associations as they would like to think." *Inside ASAE*, Vol. 1, No. 18, p. 2 (March 22, 1985). Similarly, the Petition actually stops short of asserting unequivocally that the decision has broad application (using qualifiers throughout such as "plausibly" and "apparently"). (Pet. 22, 24). It can also be expected to argue in future instances involving (c)(6) organizations that the decision below applies only to a (c)(3).

"depends upon the facts and circumstances." Since both the statute and regulations unambiguously contradict the existence of a *per se* rule, resort to the legislative history is unnecessary, if not inappropriate.[20] *United States v. Oregon*, 366 U.S. 643, 648 (1961).

The government argues that because testimony at the time of the amendment was heard from various publishers of professional journals, including the College, urging that their advertising substantially contributed to the accomplishment of exempt purposes, the 1969 amendments to the Code constituted a legislative rejection of their position. It is equally logical to assume, however, as the court of appeals did below, that Congress' retention of the "substantial relationship test," and its failure to simply classify advertising revenues as taxable income if that was what it intended to do, was a clear rebuff of the *per se* position and a recognition that advertising income of certain organizations might still qualify for exemption. (Pet. App. 13a). As the court of appeals stated below, "[W]hile the committee may have believed that advertising income should be taxed, it did not adopt a blanket rule." (Pet. App. 12a).

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20. The court of appeals correctly noted that "[t]he legislative history addresses advertising generally and does not grapple with specific factual situations." (Pet. App. 13a). The general statements in the committee reports on which the government relies (Pet. 15, 16), if read as stating that all advertising income of all exempt organizations would be taxable, cannot be squared with the portion of Section 513 that was not amended, the facts-and-circumstances test of the Regulations, and Example 5 of Treas. Reg. §1.513-1(d)(4). Those statements are best understood as reflecting an understanding that relatively few exempt organizations — and perhaps no (c)(6) organizations — would be able to make a factual showing that the advertising in their publications "contribute[s] importantly" to the purposes underlying their exemption. The decision below is not to the contrary.

B. The Government Overstates the Impact of the Decision Below

The government argues that the decision below will have a substantial but unquantified impact on revenues (Pet. 23-24), and, by assertedly creating a new requirement of case-by-case factual analysis, will pose "an almost insurmountable audit problem." (Pet. 24). Both contentions rest upon the government's erroneous premise that the decision below is broad in scope and applies to all exempt organizations. In any event, neither contention is correct, and the government's exaggerated "parade of horrors" cannot withstand close examination. The decision below, merely correcting the trial court's factual analysis of the relationship between the advertising in *Annals* and the College's exempt goals as a (c)(3) organization, should not have major impact.[21]

Many tax-exempt organizations that publish journals are exempt pursuant to Section 501(c)(6). As to them, Example 7 will still remain as an obstacle to avoiding a tax on advertising income. Even among the (c)(3) organizations, few are likely to be able to offer the unrebutted testimonial proof which the College offered below that its advertising, even if having a commercial character, still bears a substantial relationship and contributes importantly to the accomplishment of its exempt purposes. Few are likely to be able to point to a connection so significant as the premiere role of advertising in apprising or reminding practicing internists of new pharmaceutical developments and other important information.[22]

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21. Significantly, President Reagan's recent 500-page proposal for extensive revisions to the Internal Revenue Code, released after the Petition in this case, did not feel it necessary to address this issue nor any issue related to the unrelated business income tax.

22. It is difficult to imagine *National Geographic* or a college alumni magazine, for example, successfully establishing a substantial relationship between the advertising carried in their pages and exempt goals of their underlying organizations.

The data presented by the government thus become largely irrelevant. We are advised by IRS that all three of the medical journals named by the government as having substantial advertising revenues (Pet. 23) are published by (c)(6) organizations. Of the 45 journals published by exempt organizations identified by the government as among the 400 largest (Pet. 23), only 22 are published by organizations exempt pursuant to Section 501(c)(3), and only three of these journals appear to contain "substantially related" advertising.[23] The government refers to proposed tax deficiencies of $29.6 million based upon examinations over *two* years, of *all* forms of tax-exempt periodicals (Pet. 23-24), but there is no indication of the extent to which (c)(3) organizations were involved.

The government's speculations as to "formidable burdens on IRS audit resources" (Pet. 24) similarly are unpersuasive. As required by the Code and the Regulations, IRS already performs a factual analysis with respect to advertising and other business activities. *See, e.g.*, Section 513(a)(2) (activities carried on primarily for convenience of members exempt); Treas. Reg. §1.513-1(d)(3) (IRS must determine whether activity is conducted on "larger scale than is reasonably necessary"); Treas. Reg. §1.513-1(d)(4) Example 5 (advertising revenue from college newspaper exempt); Rev. Rul. 73-104 (sale of greeting card reproductions of art works by mu-

23. The names of the 45 magazines were provided to us by IRS. We compared the list of publishers to the Cumulative List of Organizations described in Section 170(c) (Publication 78) published by IRS on the assumption that the organizations listed therein are qualified under Section 501(c)(3). We then sought to examine the magazines published by the 22 organizations listed in Publication 78 to determine the nature of the advertising. Four of the publications could not be located and we questioned the organizations by telephone as to the nature of their advertising, if any. Based on this review, we concluded that only three of the publications (other than *Annals*) contained advertising which could be argued to be "substantially related."

seum exempt). The few (c)(3) returns that might require factual analysis as a result of this case should not require any unusual IRS effort.

As for the government's suggestion that exempt organizations will attempt to "manipulate" their tax outcome by advising their advertisers to insert "incidental 'educational' boilerplate" in their ads (Pet. 25), any such "incidental" matter is unlikely to satisfy the "contribute importantly" test. This unfounded suggestion is particularly out of bounds in this case, where the vast majority of the advertising is for prescription drugs, and its informational content so important that it is mandated (if not "manipulated") by the government itself.[24]

Finally, the government urges that the decision below will "flout" a "sharply defined legislative policy" to prevent unfair competition between exempt and non-exempt organizations in business activities. (Pet. 25). The short answer is that Congress clearly contemplated that income from a trade or business activity bearing a substantial relationship to exempt purposes should be exempt from tax despite the existence of non-exempt competitors. The mere existence of such competitors is thus irrelevant. *See* Rev. Rul. 80-295, 80-296, 1980-2 C.B. 194, 195. Furthermore, the government's suggestion that the College will charge lower rates for advertising based upon its income tax status is merely speculative, and contradictory to its Stipulation below that rates are set by relation to the College's costs in publishing the ads and the need to be competitive with other

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24. Unfortunately, here the government itself has engaged in some "manipulation," by emphasizing in its Appendix the relatively few advertisements which appeared for over-the-counter products, and by totally deleting from the advertisements for prescription drugs the detailed technical information they contain. To correct any misimpression the government's selective editing otherwise may create, the College has included in Appendix B an example of the information deleted from the ad for "Anspor" incompletely reproduced at Pet. App. 73a.

journals. (C.A. App. 22A). A decision that the advertising in *Annals* is not subject to tax is not likely to affect either the journal's circulation, or that of any of its commercial competitors. The tax burden, on the other hand, would lessen the funds available for the College's other educational activities.

Should any of the government's speculations come to pass, the government still possesses ample means to address the problem without recourse to this Court in the present case. If significant numbers of (c)(6) organizations challenge Example 7 and claim exemption, the issue of the determination of the Example's validity will then be ripe, either in other circuits (where some cases involving (c)(6) organizations are already pending) or in the court below. The government can obtain a clear ruling on a *per se* rule by seeking summary judgment in a more appropriate case, rather than by endorsing factually oriented litigation. The IRS could also issue a clarification to Example 7 expressly stating the statutory basis for a *per se* rule for commercial advertising in publications of (c)(6) organizations, or could devise reporting requirements designed to alert it to returns reflecting a claim of substantially related advertising. Should "unfair competition," substantial audit burdens, or significant loss of revenue occur, and if the legislative intent is half as clear as the government contends, Congress can provide appropriate clarification. This case is a premature and inappropriate vehicle for the resolution of these issues.

C. No Conflict Exists Requiring Resolution by This Court

The government concedes that this case presents no conflict among the circuits which requires resolution by this Court. (Pet. 25). It notes, in fact, the existence of three suits pending outside of the Federal Circuit presenting the issues addressed by the government in its petition, all as yet undecided. (Pet. 25 n.14). Indeed, the

government appears to be arguing that this Court should review the decision below *because* there is no conflict and the Federal Circuit offers a nationwide forum for taxpayers to litigate their refund claims. This Court's Rules, however, specifically provide that review of decisions of the Court of Appeals for the Federal Circuit is to be controlled by the same considerations applicable to the review of decisions of all other courts. Sup. Ct. Rule 17.2.[25]

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25. Furthermore, that court was created to render decisions of nationwide application in certain specialized areas of the law, to which its jurisdiction is limited, in order to lessen the need for resort to this Court. S. Rep. No. 275, 97th Cong., 2d Sess. 3-4 (1981), *reprinted in* 1982-2 *U.S. Code Cong. & Ad. News* 13-14. *Cf.* NYU Sup. Ct. Project, Executive Summary 67 (1985) (identifying tax litigation as an area where the Court should not "feel strongly any temptation to intervene" by reviewing decisions of the Court of Appeals for the Federal Circuit. The judges appointed to the Court of Appeals for the Federal Circuit possess significant and specialized expertise in these areas. Judge Smith, for example, the author of the opinion below, served as the Chief of the Trial Section of the Tax Division of the United States Department of Justice, followed by a distinguished career in private tax practice. Thus, the government's argument that the jurisdiction of the court below somehow gives its decisions a special claim to the attention of this Court completely subverts the Congressional intent.

CONCLUSION

For the foregoing reasons, the government's petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

Appendix A

Treasury Regulations on Income Tax (1954 Code)

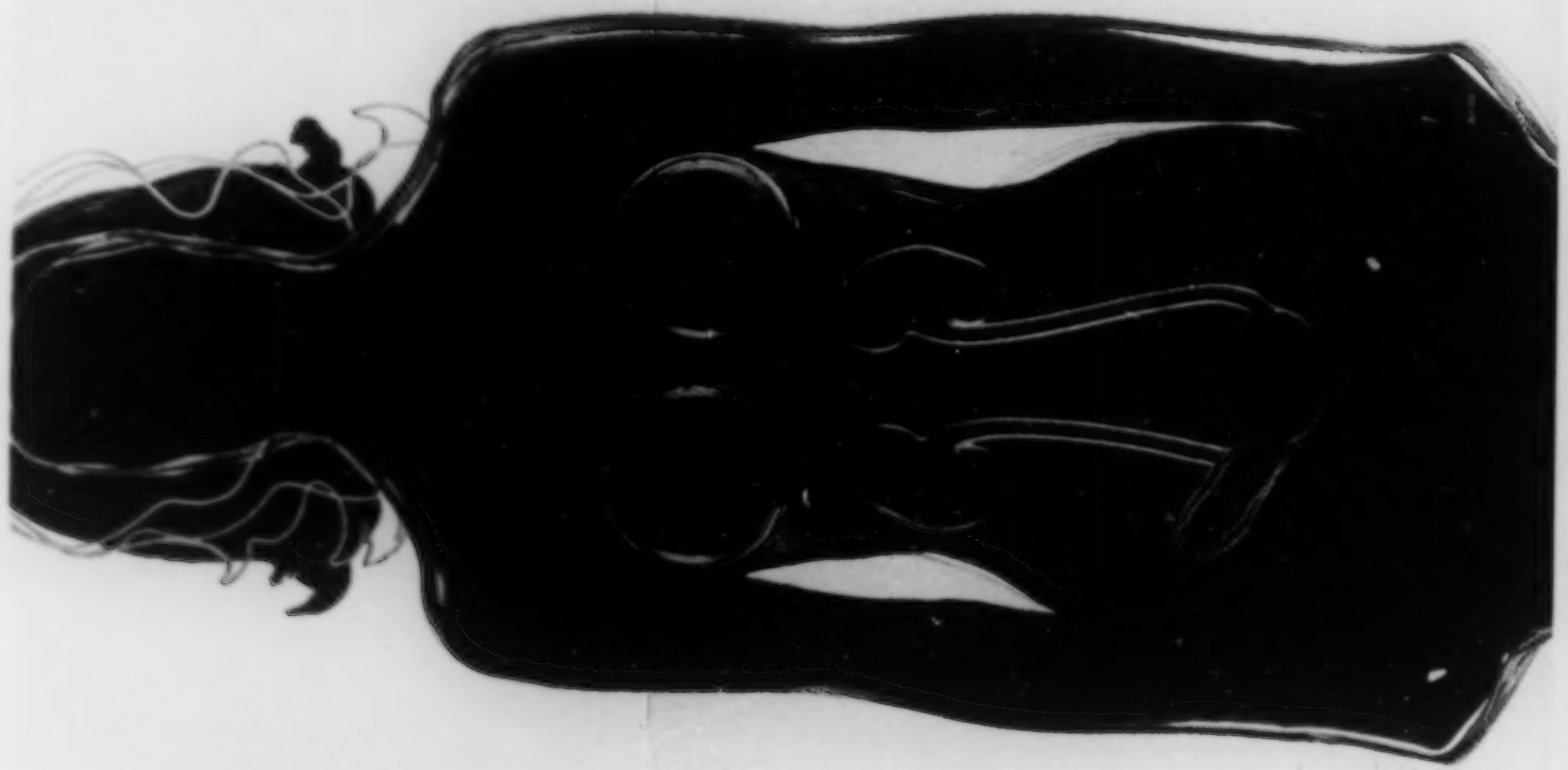
1.513-1(d)(3). Size and extent of activities. In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

New from SK&F

AMPICEPHRADINE™

BRAND OF CEPHRADINE

capsules: 250 and 500 mg.
for oral suspension: 125 and 250 mg./5 ml.



SK&F
SMITH KLINE
& FRENCH
LABORATORIES

BEST AVAILABLE COPY

A New Oral Antibiotic with these Important Features:

- **Bactericidal activity *in vitro*.**
- **Effective against a wide range of Gram-positive and Gram-negative infections due to susceptible organisms:**

  Respiratory tract infections caused by group A beta-hemolytic streptococci and *D. pneumoniae*.

  Urinary tract infections caused by *E. coli*, *Pr. mirabilis*, and *Klebsiella* species.

  Skin and soft-tissue infections caused by staphylococci.

  Otitis media caused by group A beta-hemolytic streptococci, *D. pneumoniae*, *H. influenzae* and staphylococci.

  Culture and susceptibility tests should be initiated prior to and during therapy. Renal function studies should be performed when indicated.

- **Documented safety.**
- **Rapidly absorbed. Average peak serum levels within 1 hour.**
  (Approximately 9 and 16.5 mcg./ml. at 1 hour with 250 and 500 mg. capsules, respectively, in normal adult volunteers.)
- **High urinary levels.**
  (Peak concentration of approximately 3200 mcg./ml. with 500 mg. capsule dose in normal adult volunteers.)
- **Excreted essentially unchanged in the urine.**
- **Acid stable. Can be given without regard to meals.**

'Anspor' is contraindicated in patients with known hypersensitivity to the cephalosporins. **In penicillin-sensitive patients, cephalosporin C derivatives should be used with great caution because of evidence of partial cross-allergenicity of the penicillins and the cephalosporins.**

Adverse Reactions

The following adverse reactions have been reported: glossitis, nausea, vomiting, diarrhea or loose stools, abdominal pain and heartburn; mild urticaria or skin rash, pruritus, joint pains; transient eosinophilia, leukopenia, neutropenia; transient rise of SGOT, SGPT, total bilirubin, BUN; dizziness, tightness in the chest, and candidal vaginitis.

For a brief summary of prescribing information, including indications, contraindications, warnings, precautions, adverse reactions, and dosage, please see the following page.

New from SK&F

ANSPOR™

BRAND OF

CEPHRADINE

capsules: 250 and 500 mg.
for oral suspension: 125 and 250 mg./5 ml.

Before prescribing, see complete prescribing information in SK&F literature. The following is a brief summary.

DESCRIPTION

Anspor (cephradine, SK&F) is a semi-synthetic cephalosporin antibiotic chemically designated as 7-[D-2-amino-2-(1,4-cyclohexadien-1-yl) acetamido]-3-methyl-8-oxo-5-thia-1-azabicyclo[4.2.0]-oct-2-ene-2-carboxylic acid.

ACTIONS

Microbiology: *In vitro* tests demonstrate that the cephalosporins are bactericidal because of their inhibition of cell-wall synthesis. Cephradine is active against the following organisms *in vitro*:

Beta-hemolytic streptococci	*Diplococcus pneumoniae*
Staphylococci, including coagulase-positive, coagulase-negative, and penicillinase-producing strains	*Escherichia coli*
	Proteus mirabilis
	Klebsiella sp.
	Hemophilus influenzae

Note—Some strains of enterococci (*Streptococcus faecalis*) are resistant to cephradine. It is not active against most strains of *Enterobacter* sp., *Pr morganii* and *Pr vulgaris*. It has no activity against *Pseudomonas* or *Herellea* species. When tested by *in vitro* methods, staphylococci exhibit cross-resistance between cephradine and methicillin-type antibiotics.

INDICATIONS

Anspor (cephradine, SK&F) is indicated in the treatment of the following infections when caused by susceptible strains of designated micro-organisms.

Infections of the respiratory tract (e.g., tonsillitis, pharyngitis, and lobar pneumonia) caused by group A beta-hemolytic streptococci and *D pneumoniae*

(Penicillin is the usual drug of choice in the treatment and prevention of streptococcal infections, including the prophylaxis of rheumatic fever. 'Anspor' is generally effective in the eradication of streptococci from the nasopharynx; substantial data establishing the efficacy of 'Anspor' in the subsequent prevention of rheumatic fever are not available at present.)

Otitis media caused by group A beta-hemolytic streptococci, *D pneumoniae*, *Hemophilus influenzae* and staphylococci.

Infections of the skin and soft tissues caused by staphylococci.

Infections of the urinary tract, including prostatitis, caused by *Escherichia coli*, *Pr mirabilis*, and *Klebsiella* species.

Note—Culture and susceptibility tests should be initiated prior to and during therapy. Renal function studies should be performed when indicated.

CONTRAINDICATIONS

Anspor (cephradine, SK&F) is contraindicated in patients with known hypersensitivity to the cephalosporin group of antibiotics.

WARNINGS

IN PENICILLIN-SENSITIVE PATIENTS, CEPHALOSPORIN C DERIVATIVES SHOULD BE USED WITH GREAT CAUTION. THERE IS CLINICAL AND LABORATORY EVIDENCE OF PARTIAL CROSS-ALLERGENICITY OF THE PENICILLINS AND THE CEPHALOSPORINS, AND THERE ARE INSTANCES OF PATIENTS WHO HAVE HAD REACTIONS TO BOTH DRUGS (INCLUDING FATAL ANAPHYLAXIS AFTER PARENTERAL USE).

Any patient who has demonstrated some form of allergy, particularly to drugs, should receive antibiotics cautiously and then only when absolutely necessary.

Usage in Pregnancy and Lactation: Safety of this product for use in pregnancy has not been established. Cephradine is secreted in breast milk during lactation.

PRECAUTIONS

Follow patients closely to detect side effects or unusual manifestations of drug idiosyncrasy. If hypersensitivity reaction occurs, discontinue drug and treat patient with usual agents, e.g., pressor amines, antihistamines, or corticosteroids.

Administer with caution in presence of markedly impaired renal function. In known or suspected renal impairment, careful clinical observation and appropriate laboratory studies should be made prior to and during therapy as cephradine accumulates in the serum and tissues. See *DOSAGE AND ADMINISTRATION* section for information on treatment of patients with impaired renal function.

Prolonged use of antibiotics may promote the overgrowth of non-susceptible organisms. Take appropriate measures if superinfection occurs during therapy.

After cephradine therapy, a false positive reaction for glucose in the urine may occur with Benedict's solution, Fehling's solution, or with Clinitest® tablets, but not with enzyme-based tests such as Clinistix® and Tes-Tape®.

A positive Coombs test may be due to the drug.

Indicated surgical procedures should be performed in conjunction with antibiotic therapy.

ADVERSE REACTIONS

The following adverse reactions have been reported:

Gastrointestinal: Glossitis, nausea, vomiting, diarrhea or loose stools, abdominal pain and heartburn.

Skin and Hypersensitivity Reactions: Mild urticaria or skin rash, pruritus, and joint pains.

Blood: Mild, transient eosinophilia, leukopenia and neutropenia.

Liver: Transient mild rise of SGOT, SGPT, and total bilirubin with no evidence of hepatocellular damage.

Renal: Transitory rises in BUN. In adults for whom serum creatinine determinations were performed, the rise in BUN was not accompanied by a rise in serum creatinine.

Other adverse reactions have included dizziness and tightness in the chest and candidal vaginitis.

DOSAGE AND ADMINISTRATION

Anspor (cephradine, SK&F) may be given without regard to meals.

Adults: For skin and soft-tissue and respiratory tract infections (other than lobar pneumonia), the usual dose is 250 mg. q.i.d. in equally spaced doses. For acute infections of the urinary tract, including prostatitis, and pneumococcal lobar pneumonia, the usual dose is 500 mg. q.i.d. in equally spaced doses; severe or chronic infections may require larger doses.

Children: The usual dose is 25 to 50 mg./kg./day total, q.i.d. in equally divided and spaced doses. For otitis media due to *H. influenzae*, doses from 75 to 100 mg./kg./day in equally divided and spaced doses are recommended. Maximum dose should not exceed 4 grams per day.

All patients, regardless of age and weight: Larger doses (up to 1 gram, q.i.d.) may be given for severe or chronic infections.

In patients with impaired renal function, a modified dosage schedule is necessary. Consider each patient individually utilizing the following guideline: In adults, initial loading dose is 750 mg. and maintenance dose is 500 mg. at following time intervals: creatinine clearance >20 ml./min., 6-12 hours between doses; creatinine clearance 15-19 ml./min., 12-24 hours between doses; creatinine clearance 10-14 ml./min., 24-40 hours between doses; creatinine clearance 5-9 ml./min., 40-50 hours between doses; creatinine clearance <5 ml./min., 50-70 hours between doses. Further modification may be necessary in children.

HOW SUPPLIED

ANSPOR (cephradine, SK&F) Capsules—250 and 500 mg.

'ANSPOR' for Oral Suspension—Pleasant fruit-flavored oral suspension which, after reconstitution, provides 125 mg. or 250 mg. of cephradine per 5 ml. teaspoonful.

SK&F Smith Kline & French Laboratories
Division of SmithKline Corporation, Philadelphia, Pa. 19101

BEST AVAILABLE COPY

A New Oral Antibiotic

Office - Supreme Court, U.S.
FILED
JUN 14 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1737

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA,
Petitioner,

v.

THE AMERICAN COLLEGE OF PHYSICIANS,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

RESPONDENT'S MEMORANDUM IN OPPOSITION TO MOTION OF AMERICAN BUSINESS PRESS FOR LEAVE TO FILE AMICUS BRIEF

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COURT RULES:

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RESPONDENT'S MEMORANDUM IN OPPOSITION TO MOTION OF AMERICAN BUSINESS PRESS FOR LEAVE TO FILE AMICUS BRIEF

Respondent American College of Physicians ("the College") opposes the motion of American Business Press ("ABP") for leave to file an amicus brief in support of the petition. The College declined to consent to the filing of ABP's brief because counsel for ABP refused to provide any information about the contents of their proposed brief or to make any commitment to try to file in advance of the deadline for the College's opposition to the petition, and past experience with ABP in this case indicated a likelihood that the ABP brief would make unsupported, inaccurate statements which could mislead the Court if there were no response. Such apprehensions were well-founded, for much of ABP's brief is inaccurate, distorted,

irrelevant or not in compliance with this Court's rules. Without answering in detail, we note several examples.

1. ABP proffers purportedly representative copies of advertisements for a prescription drug, including one from the January 1985 *Annals*, as illustrating "what this case is all about" (ABP Br. 4-5). However, the copies reflect virtually none of the important content of the advertisements, even though "what this case is all about" is whether there is a substantial relationship between such advertisements (in the 1975 *Annals*) and the exempt educational purpose of the College. Thus, like the government, ABP has made a misleading presentation of the advertisements. What has been assertedly "reproduced" is but one page of an eight-page advertisement introducing a new prescription drug, which contains an abundance of detailed technical information that is important for the physician-readers of *Annals* to know (pp. I-17 to I-24).[1] Most such information in the two full columns of copy on the page excerpted by ABP (a legible copy of which is appended hereto as Appendix A) has been totally obscured, eliminated or otherwise omitted in the reproduction process.[2]

2. ABP asserts broadly that the primary purpose of Section 513 is to protect non-exempt organizations from "unfair competition" by exempt organizations (ABP Br. 4-7). In fact, Congress chose to address competition only insofar as it came from *unrelated* trade or business activities of exempt organizations, which it defined as those not

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[1] We are lodging with the Clerk a copy of the January 1985 issue of *Annals*.

[2] The reproductions of the advertisements in ABP's brief appear to violate Rule 33.1 of this Court concerning legibility.

"substantially related" to the purposes underlying the organization's exemption.

3. ABP implies that the "tax exempt" organizations identified as its competitors are comparable to respondent (ABP Br. 2-3), but we understand that all of them are exempt under Section 501(c)(6) of the Internal Revenue Code, and none under Section 501(c)(3), which is the only type of exempt organization involved in this case.[3]

4. ABP asserts that the Claims Court, in a "considered opinion," correctly "enforced the IRS Regulations and the Act of Congress* * *" (ABP Br. 3, 14).[4] However, ABP argued in the Court of Appeals that the Claims Court's factually oriented approach was contrary to the per se approach advocated by ABP. Moreover, in its effort to intervene in the *AMA* case (ABP Br. 16), ABP had the following to say about the instant case:

> In the *ACP* proceeding, the Government and ACP agreed that a factual inquiry into the advertising

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[3] ABP cites data concerning the total number of various categories of exempt organizations (ABP Br. 15 n.6), but fails to provide any data as to the relatively small number of such organizations that publish magazines containing advertisements from which they derive significant income, or, more importantly, the number of such organizations that could plausibly assert that such advertising contributes importantly to their exempt purposes.

[4] ABP asserts that the court of appeals, by contrast, made "no mention whatsoever" of the regulation assertedly "validated and given the force of law by Congress in 1969" (ABP Br. 3, 14), but in fact the court repeatedly analyzed and construed the regulation (Pet. App. 6a, 9a, 10a, 12a, 19a-20a). While the court did not discuss Example 7 in the regulations, on which ABP relies, that example is on its face applicable only to a Section 501(c)(6) organization, and in any event that example was not discussed or "validated" by Congress (or the committees), particularly with reference to its possible application to a Section 501(c)(3) organization such as the College.

> activity of the ACP and its relationship to exempt functions was required. In ABP's judgment, the Government never should have proceeded to a trial of "the relatedness" of ACP's advertising business to its tax-exempt purpose without asserting available legal defenses which could have been raised by summary judgment.[5]

ABP further referred to *the government's* "case-by-case approach" in this area.[6] Thus, ABP concurs with the College's characterization of the instant case, which makes it not a suitable vehicle for addressing the question the government now seeks to present.

5. ABP makes the unsupported assertion that the taxpayer in one of the three pending district court cases involving (c)(6) organizations noted in the petition (Pet. 25-26 n.3) has "indicated" that it plans to dismiss its district court action, in what ABP surmises would be "the first step" in moving its claims to the Federal Circuit (ABP Br. 15-16). However, ABP misdescribes the situation in that case[7] and fails to mention that the taxpayer in another of those cases recently amended its complaint to

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[5] Memorandum of Points & Authorities in Support of the Motion of American Business Press for Leave to Intervene, *American Medical Ass'n* v. *United States*, No. 82 C 7213 at 19 (N.D. Ill.).

[6] *Id.* at 20.

[7] We are advised that AMA has merely indicated that it had referred to the possibility of a dismissal *without prejudice*, which it could obtain at this stage of that case only in the event that the government consented or the court granted such a motion over the government's opposition (*see* Fed. R. Civ. P. 41(a)), both of which events are problematical at best. ABP also omitted to mention that the government opposed its motion to intervene in *AMA*, rejecting ABP's assertion of competitive impact in terms applicable here:

> the possibility that if the AMA wins the suit it might lower its advertising rates and divert income away from the members of

make a substantial claim that it is not likely to be dismissed in order that it can forum shop, as ABP implies.[8]

Accordingly, the motion of ABP should be denied and its brief disregarded.

Respectfully submitted,

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the ABP is, the Government submits, not an immediate, but rather a remote consequence of an adverse decision. Other than this potential economic handicap, a decision either in favor of or against the AMA can have no direct immediate effect on the ABP.

Memorandum of the United States of America Opposing Intervention By the American Business Press, *American Medical Ass'n* v. *United States*, No. 82 C 7213 at 4 (N.D. Ill.).

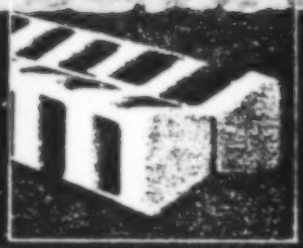
[8] We are advised that the plaintiff in *American Academy of Family Physicians* v. *United States*, Civ. No. 84-0170-CV-W-4 (W.D. Mo.), has amended the complaint to assert a claim for refund exceeding $2 million, so that there is no serious prospect that the plaintiff would suffer a dismissal in order to litigate in the Claims Court.

APPENDIX

NEW 1 tab qd

MAXZIDE™

Triamterene **75 mg**/Hydrochlorothiazide **50 mg**/Lederle



– FOR PATIENTS ON HYDROCHLOROTHIAZIDE WHO DEVELOP HYPOKALEMIA
– FOR NEWLY DIAGNOSED PATIENTS IN WHOM THE DEVELOPMENT OF HYPOKALEMIA CANNOT BE RISKED
– FOR PATIENTS TRANSFERRED FROM DYAZIDE

BRIEF SUMMARY
Please see package insert for full prescribing information.

INDICATIONS AND USAGE: MAXZIDE is indicated for the treatment of hypertension or edema in patients who develop hypokalemia on hydrochlorothiazide alone. It is also indicated for those patients who require a thiazide diuretic and in whom the development of hypokalemia cannot be risked (e.g., patients on digitalis preparations or with a history of cardiac arrhythmias, etc.). **This fixed combination drug is not indicated for the initial therapy of edema or hypertension except in individuals in whom the development of hypokalemia cannot be risked.** MAXZIDE may be used alone or in combination with other antihypertensive drugs such as beta-blockers. Since MAXZIDE may enhance the actions of these drugs, dosage adjustments may be necessary. Usage in Pregnancy. The routine use of diuretics in an otherwise healthy woman is inappropriate and exposes mother and fetus to unnecessary hazards. Diuretics do not prevent development of toxemia in pregnancy, and there is no satisfactory evidence that they are useful in the treatment of developed toxemia.

CONTRAINDICATIONS: Hyperkalemia. MAXZIDE should not be used in the presence of elevated serum potassium levels (greater than 5.5 mEq/liter). If hyperkalemia develops, this drug should be discontinued and a thiazide alone should be substituted. Concomitant use with other potassium conserving agents such as spironolactone, amiloride HCl or other formulations containing triamterene. Concomitant potassium supplementation in the form of medication, potassium-containing salt substitute or potassium-enriched diets should also not be used. Contraindicated in patients with anuria, acute and chronic renal insufficiency or significant renal impairment. Hypersensitivity to either component separately or other sulfonamide-derived drugs.

WARNINGS: Hyperkalemia

> Abnormal elevation of serum potassium levels (greater than or equal to 5.5 mEq/liter) can occur with all potassium conserving agents including MAXZIDE. Hyperkalemia is more likely to occur in patients with renal impairment, diabetes (even without evidence of renal impairment), or elderly or severely ill patients. Since uncorrected hyperkalemia may be fatal, serum potassium levels must be monitored at frequent intervals especially in patients first receiving MAXZIDE, when dosages are changed, or with any illness that may influence renal function.

If hyperkalemia is suspected, (warning signs include paresthesias, muscular weakness, fatigue, flaccid paralysis of the extremities, bradycardia and shock) an electrocardiogram (ECG) should be obtained. Monitor serum potassium levels because mild hyperkalemia may not be associated with ECG changes. If hyperkalemia is present, MAXZIDE should be discontinued immediately and a thiazide alone should be substituted. If the serum potassium level exceeds 6.5 mEq/liter, more vigorous therapy is required. The clinical situation dictates the procedures to be employed. These include the intravenous administration of calcium chloride, infusion sodium bicarbonate solution and the oral or parenteral administration of glucose with a rapid acting insulin preparation. Cation exchange resins such as sodium polystyrene sulfonate may be orally or rectally administered. Persistent hyperkalemia may require dialysis. The development of hyperkalemia is associated with potassium-sparing diuretics is exacerbated in the presence of renal impairment (see CONTRAINDICATIONS). Patients with mild renal dysfunction or impairment should not receive this drug without frequent and continued monitoring of serum electrolytes. Cumulative drug effects may be observed in patients with impaired renal function. The renal clearance of hydrochlorothiazide, the pharmacologically active metabolite of triamterene, and the sulfate ester of hydroxytriamterene have been shown to be reduced and the plasma levels increased following MAXZIDE administration to elderly patients and patients with impaired renal function. Hyperkalemia has been reported in diabetic patients with the use of potassium conserving agents even in the absence of apparent renal impairment. Avoid MAXZIDE in diabetic patients. If it is employed, serum electrolytes must be frequently monitored. Metabolic or Respiratory Acidosis. Potassium conserving therapy should also be avoided in severely ill patients in whom respiratory or metabolic acidosis may occur, since acidosis may be associated with rapid elevations in serum potassium levels. If MAXZIDE™ triamterene 75mg/hydrochlorothiazide 50mg is employed, frequent evaluations of acid-base balance and serum electrolytes are necessary.

PRECAUTIONS: Electrolyte Imbalance and BUN Increases. Patients receiving MAXZIDE should be carefully monitored for fluid or electrolyte imbalances, i.e., hyponatremia, hypochloremic alkalosis, hypokalemia and hypomagnesemia. Serum and urine electrolyte determinations should be frequently performed and are especially important when the patient is vomiting or receiving parenteral fluids. Warning signs or symptoms of fluid and electrolyte imbalance include: dryness of mouth, thirst, weakness, lethargy, drowsiness, restlessness, muscle pains or cramps, muscular fatigue, hypotension, oliguria, tachycardia and gastrointestinal disturbances such as nausea and vomiting.

Any chloride deficit during thiazide therapy is generally mild and usually does not require any specific treatment except under extraordinary circumstances (as in liver disease or renal disease). Dilutional hyponatremia may occur in edematous patients in hot weather; appropriate therapy is water restriction, rather than administration of salt, except in rare instances when the hyponatremia is life threatening. In actual salt depletion, appropriate replacement is the therapy of choice.

Hypokalemia may develop with thiazide therapy, especially with brisk diuresis, when severe cirrhosis is present, or during concomitant use of corticosteroids, ACTH, amphotericin B or after prolonged thiazide therapy. However, hypokalemia of this type is usually prevented by the triamterene component of MAXZIDE.

Interference with adequate oral electrolyte intake will also contribute to hypokalemia. Hypokalemia can sensitize or exaggerate the response of the heart to the toxic effects of digitalis (e.g., increased ventricular irritability).

MAXZIDE may produce an elevated blood urea nitrogen level (BUN), creatinine level or both. This is probably not the result of renal toxicity but is secondary to a reversible reduction of the glomerular filtration rate or a depletion of the intravascular fluid volume. Periodic BUN and creatinine determinations should be made especially in elderly patients, patients with suspected or confirmed hepatic disease or renal insufficiencies. If azotemia increases, MAXZIDE should be discontinued.

Hepatic Coma. MAXZIDE should be used with caution in patients with impaired hepatic function or progressive liver disease, since minor alterations of fluid and electrolyte balance may precipitate hepatic coma. Renal Stones. Triamterene has been reported in renal stones in association with other calculus components. MAXZIDE should be used with caution in patients with histories of renal lithiasis. Folic Acid Deficiency. Triamterene is a weak folic acid antagonist and may contribute to the appearance of megaloblastosis in instances where folic acid stores are decreased. In such patients, periodic blood evaluations are recommended. Hyperuricemia. Hyperuricemia may occur or acute gout may be precipitated in certain patients receiving thiazide therapy. Metabolic and Endocrine Effects. The thiazides may decrease serum PBI levels without signs of thyroid disturbance.

Calcium excretion is decreased by thiazides. Pathological changes in the parathyroid gland with hypercalcemia and hypophosphatemia have been observed in a few patients on prolonged thiazide therapy. The common complications of hyperparathyroidism such as renal lithiasis, bone resorption, and peptic ulceration have not been seen. Thiazides should be discontinued before carrying out tests for parathyroid function.

Insulin requirements in diabetic patients may be increased, decreased or unchanged. Latent diabetes mellitus may become manifest during thiazide administration. Hypersensitivity. Sensitivity reactions to thiazides may occur in patients with or without a history of allergy or bronchial asthma.

Possible exacerbation or activation of systemic lupus erythematosus by thiazides has been reported. Drug Interactions. Thiazides may add to or potentiate the action of other antihypertensive drugs.

The thiazides may decrease arterial responsiveness to norepinephrine. This diminution is not sufficient to preclude effectiveness of the pressor agent for therapeutic use. Thiazides have also been shown to increase responsiveness to tubocurarine.

Lithium, when given with diuretics, reduces renal clearance and increases the risk of lithium toxicity. Refer to the package insert on lithium before use of such concomitant therapy.

Acute renal failure has been reported in a few patients receiving indomethacin and one of formulations containing triamterene and hydrochlorothiazide. Caution is therefore advised when administering nonsteroidal anti-inflammatory agents with MAXZIDE.

Drug Laboratory Test Interactions. Triamterene and quinidine have similar fluorescence spectra. Thus MAXZIDE may interfere with the measurement of quinidine.

Pregnancy Category C. The safe use of MAXZIDE in pregnancy has not been established. Animal reproduction studies have not been conducted with MAXZIDE (triamterene 75mg/hydrochlorothiazide 50mg). It is also not known if MAXZIDE can cause fetal harm when administered to a pregnant woman or can affect reproductive capacity. MAXZIDE crosses the placental barrier and appears in cord blood. The use of thiazides in pregnant women requires that the anticipated benefit be weighed against possible hazards to the fetus. These hazards include fetal or neonatal jaundice, thrombocytopenia, pancreatitis, and possibly other adverse reactions which have occurred in the adult. MAXZIDE should be given to a pregnant woman only if clearly needed.

Nursing Mothers. Thiazides appear in breast milk. If the use of MAXZIDE is deemed essential, the patient should stop nursing. Pediatric Use. The safety and effectiveness of MAXZIDE in children has not been established.

ADVERSE REACTIONS: Side effects observed in association with the use of MAXZIDE include drowsiness and fatigue, insomnia, muscle cramps and weakness, headache, nausea, appetite disturbance, vomiting, diarrhea, constipation, dizziness, decreased sexual performance, shortness of breath and chest pain, dry mouth, depression and anxiety. These adverse reactions are common to other triamterene and hydrochlorothiazide containing products. Other adverse reactions include:

Hydrochlorothiazide

Gastrointestinal: anorexia, gastric irritation, cramping, jaundice (intrahepatic cholestatic jaundice), pancreatitis, sialadenitis. Central Nervous System: vertigo, paresthesias, xanthopsia. Hematologic: leukopenia, agranulocytosis, thrombocytopenia, aplastic anemia, hemolytic anemia, megaloblastosis. Cardiovascular: orthostatic hypotension (may be aggravated by alcohol, barbiturates, or narcotics). Hypersensitivity: anaphylaxis, purpura, photosensitivity, rash, urticaria, necrotizing angiitis (vasculitis, cutaneous vasculitis), fever, respiratory distress including pneumonitis. Other: hyperglycemia, glycosuria, hyperuricemia, restlessness, transient blurred vision.

Triamterene

Hypersensitivity: anaphylaxis, photosensitivity and rash. Other: Triamterene has been reported in renal stones in association with other calculus materials. Triamterene has been associated with blood dyscrasias. Whenever adverse reactions are moderate to severe, therapy should be reduced or withdrawn.

DOSAGE AND ADMINISTRATION: The recommended dosage of MAXZIDE is one tablet daily with appropriate monitoring of serum potassium levels (see WARNINGS). Patients receiving 50 mg of hydrochlorothiazide who become hypokalemic may be transferred to MAXZIDE directly. In patients requiring 50 mg of hydrochlorothiazide in whom hypokalemia cannot be risked, therapy may be initiated with MAXZIDE. There is no clinical experience with doses exceeding one tablet daily.

Normotensive patients may show their patients already taking 100 mg/50 mg tablets of triamterene and hydrochlorothiazide (totaling 50-100 mg of hydrochlorothiazide and 100-200 mg of triamterene) may be safely changed to one MAXZIDE™ (triamterene 75mg/hydrochlorothiazide 50mg) tablet per day. These patients should [illegible] after the transfer.

Lederle

LEDERLE LABORATORIES
A Division of American Cyanamid Company
Wayne, New Jersey 07470

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No. 84-1737

In the Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

The thrust of respondent's brief is that the court of appeals decided this case "on a narrow factual basis" (Br. in Opp. 10). Respondent accordingly disputes our contentions as to the decision's administrative importance and revenue impact (*id.* at 15-18).

1. The ultimate question in most cases involving the unrelated business income tax is whether the business is "substantially related" to accomplishment of the organization's tax-exempt purposes (I.R.C. § 513(a)). The answer to this question will ultimately depend "upon the facts and circumstances involved" (Treas. Reg. § 1.513-1(d)(2)). In reaching an answer, however, the trier of fact must be guided by proper legal standards. We argued to the Claims Court that the legal standard relevant here is set forth in Example 7 to Treas. Reg. § 1.513-1(d)(4)(iv), which Congress explicitly approved in 1969 and determined to "place[ ]

in the tax laws" (S. Rep. 91-552, 91st Cong., 1st Sess. 75 (1969)). Example 7 concludes that a tax-exempt professional association's publication, in its scholarly journal, of advertising "designed and selected in the manner of ordinary commercial advertising is not an educational activity"; that publication of such advertising "does not contribute importantly to the accomplishment of [the organization's] exempt purposes"; and that the income from such advertising "constitutes gross income from unrelated trade or business." Under this legal standard, we argued, it was incumbent on respondent to show that its advertising differs from that described in Example 7, *i.e.*, to show that its advertising is not "designed and selected in the manner of ordinary commercial advertising."

The Claims Court accepted our legal argument. It noted that the "Treasury Regulations provide that advertising income of journals like *Annals* generally is taxable," and it ruled that "Example 7 * * * closely resembles the situation here" (Pet. App. 29a). The court then held that respondent had failed to prove that its advertising differed from that described in the Regulation. The advertising in *Annals*, the court found, "was typical commercial publicity," and respondent's advertising business "was operated in material respects like the advertising business of any other publication" (Pet. App. 28a, 33a).[1]

---

[1]Respondent contends (Br. in Opp. 7, 11 & n.17) that, under the legal theory advanced in our petition, a trial would have been unnecessary in this case, and hence that our position represents a change from the position we took in the Claims Court, where we did not seek summary judgment. This contention is incorrect. We contended below that Example 7 sets forth the controlling legal standard; we agreed, however, that respondent was entitled to prove that its advertising differs from the advertising described in that Example. The Claims Court held a trial for that purpose, and, as noted in the text, concluded that respondent had failed to carry its burden of proof.

On appeal, respondent contended that the Claims Court had "mistakenly concentrated upon [the commercial] aspects" of its advertisements and in so doing had "applied the wrong legal standard" (C.A. Br. 8). While appearing to concede the validity of the Regulation (*id.* at 33), respondent argued that Example 7 should be interpreted as applying only to advertising published by organizations exempt from tax under Section 501(c)(6), and not to advertising published by organizations (like itself) exempt under Section 501(c)(3) (C.A. Br. 30-31). Respondent concluded that "[t]he standard which the lower court applied * * * goes far beyond statutory and administrative language and intent, and constitutes a clear error of law requiring reversal in this case" (*id.* at 27, 33-34).

The Federal Circuit agreed with respondent that the Claims Court had "erred in requiring [its advertising] activity to meet a standard higher than set out in the statute" (Pet. App. 17a). The court brushed aside the legislative history upon which we relied, asserting that it "addresses advertising generally and does not grapple with specific factual situations" (*id.* at 13a). The court did not even mention the Regulation we contended was controlling. And it held that the trial judge, in relying on "the similarity [of respondent's advertising] to the content and conduct of advertising in commercial publications," had incorrectly evaluated respondent's ads under "a more rigorous standard than is supported by the statute" (*id.* at 16a).[2]

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[2]As emphasized by respondent (Br. in Opp. 9, 11) and by amicus American Society of Association Executives (Br. 3, 6), the court of appeals ruled that the trial court's ultimate finding — that respondent's advertising was not "substantially related" to its exempt educational purposes — was "clearly erroneous" (Pet. App. 19a). The Federal Circuit, however, accepted all the Claims Court's findings of basic or subsidiary fact; it reversed because (as the quotations in the text show) it believed that the Claims Court had evaluated those facts under an incorrect legal standard.

As this review shows, the issues presented by this case are not "factual." We contend that Section 513(c), its legislative history, and the Treasury Regulation Congress explicitly approved in 1969 establish that revenues from advertising "designed and selected in the manner of ordinary commercial advertising" are subject to unrelated business income tax (Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7)). Respondent contends that the Regulation does not apply to it (Br. in Opp. 11-13), and that the legislative history, read as we would read it, "cannot be squared" with the governing statute (*id.* at 14 & n.20). The questions presented, in short, concern the correct interpretation of the statute and the Regulation in light of the pertinent legislative history. These questions are obviously "legal" questions. Indeed, since respondent (as discussed below) concedes the validity of the Regulation, and hence concedes that its advertising revenues would be taxable if it were organized under Section 501(c)(6) rather than under Section 501(c)(3), the only question is the proper scope of Example 7, and the case thus presents no factual issue at all.

2. a. On the merits, respondent's attempt to posit a dichotomy in the treatment of advertising income, depending on whether the organization that publishes the advertisements is exempt under Section 501(c)(3) or Section 501(c)(6), is both unprecedented and wrong. Section 501(c)(3) provides a tax exemption for entities "organized and operated exclusively for * * * educational [and other specified] purposes." Section 501(c)(6) provides an exemption inter alia for "[b]usiness leagues." In order to qualify for exemption under the latter Section, an organization's activities must be "directed to the improvement of business conditions of one or more lines of business." Treas. Reg. § 1.501(c)(6)-1. See *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472 (1979). Providing educational services to members on subjects germane to their professional

interests is among the purposes that may qualify an association for exemption as a "business league." *E.g., National Leather & Shoe Finders Ass'n* v. *Commissioner*, 9 T.C. 121 (1947). See generally *Louisiana Credit Union League* v. *United States*, 693 F.2d 525, 535-536 (5th Cir. 1982).

A professional association like respondent, whose members are drawn from a single profession and which has broad educational or charitable goals, generally has the option of qualifying for tax exemption *either* as an educational association under Section 501(c)(3) *or* as a business league under Section 501(c)(6). The chief differences are pragmatic. Section 501(c)(3) groups may receive donations that are deductible by individual donors as charitable contributions, whereas business leagues may not. See I.R.C. § 170(c)(2). Section 501(c)(3) groups, on the other hand, may not engage in political campaign activity or in substantial lobbying without forfeiting their tax exemption, while business leagues do not operate under those constraints. Compare I.R.C. § 501(c)(3) with I.R.C. § 501(c)(6). Thus, the form of tax exemption chosen by a professional association like respondent will typically depend on funding considerations and on the intended scope of its activities. Respondent and the American Psychiatric Association, for example, both of which publish scholarly medical journals for their members, are tax-exempt under Section 501(c)(3). The American Medical Association and the American Dental Association, which likewise publish scholarly medical journals for their members, are exempt under Section 501(c)(6).

b. Respondent notes that the organization described in Example 7 is "an association exempt under Section 501(c)(6), formed to advance the interests of a particular profession and drawing its membership from the members of that profession." Treas. Reg. § 1.513-1(d)(4)(iv) (Examples 6 & 7). Respondent expressly waives any challenge to

the validity of this Regulation (Br. in Opp. 12), and concedes that "the IRS may plausibly contend that Example 7 is a shorthand determination that advertising will not have a 'substantial relationship' to an exempt purpose for a [Section 501](c)(6) organization" (*ibid.*). Respondent contends, however, that "[t]he same cannot be said" for a charitable or educational group described in Section 501(c)(3) (Br. in Opp. 12).

The distinction respondent seeks to draw is utterly unprecedented. In the long, detailed history of this issue, we know of no instance (and respondent cites none) in which Congress, a court, or a commentator has suggested that the principles of Example 7 are confined to advertising published by Section 501(c)(6) organizations, to the exclusion of advertising published by other tax-exempt groups.[3] Spokesmen for numerous Section 501(c)(6) organizations (such as the American Medical Association, the American Dental Association, and the American Physical Therapy Association) and for numerous Section 501(c)(3) organizations (such as the American Psychiatric Association, the American Osteopathic Association, and respondent) testified before Congress in 1969. These spokesmen analyzed Example 7 in detail; at no point did they suggest that the taxability of advertising revenues from their medical journals would depend on the particular subsection of Section 501(c) under which they happened to be organized. Congress recited that the Regulation it aimed to codify had

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[3]Neither court below accepted, or even mentioned, respondent's suggested distinction. Commentators who have considered respondent's argument since the decision below was issued agree that the attempted distinction is meritless. See Weinberg & Nixon, *What are the implications of the Federal Circuit's holding in American College*? 62 J. Tax. 242, 243 (1985) ("[I]t may be that the court [of appeals] viewed Example 7 as inapplicable to a 501(c)(3) organization, but nothing in Example 7 suggests [that] such a restrictive application was intended by the Treasury.").

"mainly affected the advertising income of publications such as medical journals" (H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969)), and stated that, under the statutory standard it was then adopting, "advertising in a journal published by an exempt organization is not related to the organization's exempt functions" (*id.* at 50). Congress drew no distinction on that score between different species of tax-exempt groups that publish professional journals containing advertising.

Respondent's suggested distinction, moreover, makes no sense as a construction of the Regulation. While it is true that there are some "differences in purposes" (Br. in Opp. 12) between Section 501(c)(3) groups and Section 501(c)(6) groups, those differences, in the case of professional associations like respondent, are usually slight (see page 5, *supra*), and in any event are irrelevant in this context. A tax-exempt publisher of a professional journal, whether it claims exemption under Section 501(c)(3) or Section 501(c)(6), clearly has *educational* purposes. Indeed, Example 7 recites that "continuing education of its members in matters pertaining to their profession" is one of the purposes for which the business league described in that Example is granted exemption. It is the educational character vel non of the *advertising* that determines whether the resulting revenues are subject to unrelated business income tax. Example 7 squarely holds that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute" (*ibid.*). It can scarcely be contended that such advertising would become more "educational" simply by virtue of being published by an organization claiming exemption under Section 501(c)(3). Either the advertising is "educational" or it is not.

Respondent's suggested distinction, finally, makes nonsense of the policy of the unrelated business income tax. Congress enacted that tax, and amended it in 1969 specifically to bring advertising revenues within its scope, in order to prevent tax-exempt groups from obtaining an unfair advantage over their taxable competitors in the marketplace. On respondent's theory, revenues from a drug advertisement run in the journal of the American Medical Association, a Section 501(c)(6) group, would be subject to tax, while revenues from an identical drug advertisement run in its own journal would be exempt from tax, simply because it chose to be organized under Section 501(c)(3). The provenance of respondent's tax exemption, however, makes no difference to the taxpaying publishers with which it competes, and respondent's theory would perpetuate the unfair competition that Congress in 1969 aimed to stop. Indeed, respondent's theory would exacerbate the problem, for it would enable some tax-exempt publishers to compete unfairly, not only with taxpaying publishers, but with other tax-exempt publishers as well.

In sum, there is no merit to respondent's argument that the principles of Example 7 do not apply to it. It will not do for respondent to posit an erroneous distinction, suggest that the court of appeals, by its silence, "obviously agreed" with it (Br. in Opp. 13), and thereby excuse that court for ignoring a Regulation that Congress explicitly approved and that precisely describes the situation here.[4]

---

[4]Contrary to respondent's contention (Br. in Opp. 6, 12, 14 n.20), Example 5 of the Regulation provides no support for its position. As we noted in our petition (at 19 & n.10), Example 5 concerns advertising published in a student-run campus newspaper, where "solicitation, sale, and publication of the advertising are conducted by students, under the supervision and instruction of the university" (Treas. Reg. § 1.513-1(d)(4)(iv)(Example 5)). The Example concludes that "the advertising business contributes importantly to the university's educational program through the training of the students involved" (*ibid.*). Noting that

3. Respondent's contention that this case lacks importance, on the theory that only "a handful of organizations exempt from tax pursuant to Section 501(c)(3)" will benefit from the decision below (Br. in Opp. 10), similarly lacks merit. That contention rests on respondent's argument that Section 501(c)(3) publishers and Section 501(c)(6) publishers are differently situated for purposes of the unrelated business income tax on journal advertising income. As we have pointed out, that attempted distinction is erroneous. Indeed, the tax-exempt press, far from suggesting that the decision below has "a narrow factual basis" (Br. in Opp. 10), has hailed it as "undoubtedly a landmark decision" that may enable "many non-profit associations * * * to establish that their journal advertising is substantially related to exempt purposes and not subject to taxation." 22 *Non-Profit Organization Tax Letter* No. 13, Oct. 5, 1984, at 3.[5]

Example 5 involves a university, a Section 501(c)(3) organization, respondent regards Example 5 as standing for the proposition that advertising published by Section 501(c)(3) groups is more likely (compared to advertising published by Section 501(c)(6) groups) to be "substantially related" to educational purposes (Br. in Opp. 12, 14 n.20). This suggestion is meritless. Example 4, the immediately preceding Example, also involves a Section 501(c)(3) group, one organized to advance "public interest in classical music," which owns a radio station; Example 4 concludes that the station's revenues "from the regular sale of advertising time to commercial advertisers in the manner of an ordinary commercial station" are taxable as unrelated business income. Treas. Reg. § 1.513-1(d)(4)(iv)(Example 4). Obviously, in these Examples, it is the similarity vel non of the advertising to *commercial* advertising, not the subsection of Section 501(c) under which the publisher is organized, that dictates the tax outcome.

[5]The newsletter also reminded tax-exempt groups that the decision below, unless reversed by this Court, "will become the governing law in the United States Claims Court which is a national court in which any organization may seek review of adverse determinations of the Internal Revenue Service." 22 *Non-Profit Organization Tax Letter* No. 13, Oct. 5, 1984, at 3. The newsletter suggested that, "[a]s long as this case stands, many associations should file their [tax returns] for 1984 showing no income tax on the advertising and refunds should be claimed for prior years." 22 *Non-Profit Organization Tax Letter* No. 14, Oct. 19, 1984, at 4.

Nor is there merit to respondent's argument (Br. in Opp. 15) that the nature of its advertising — being aimed at doctors — gives it a unique claim to exemption from the unrelated business income tax. After all, Congress said in 1969 that the Regulation it intended to codify "mainly affected the advertising income of publications such as medical journals" (H.R. Rep. 91-413, *supra*, at 44). The Claims Court found that respondent's advertising "was typical commercial publicity" (Pet. App. 28a), and respondent acknowledges that its ads are often identical to those appearing in medical journals published by taxpaying companies (Br. in Opp. 4-5 n.6). Indeed, amicus American Business Press advises (Br. 4-5) that one recent ad from *Annals* was carried in 25 other publications. The fine print in respondent's ads (see Br. in Opp. 3-4 & n.5) surely does not distinguish it from other publishers of medical journals, for that fine print typically reflects restrictions imposed by the FDA on the content of drug advertisements — restrictions that apply, of course, to all prescription drug advertisements across the board.

The effect of the decision below will be felt, moreover, in many areas besides medicine. Respondent has not advanced (and we cannot imagine) any reason why architects, chemical engineers, or water pollution experts would be less able than doctors to maintain that their professional goals are fostered by information contained in advertisements that "alert" them to developments in their respective fields. The reasoning of the decision below can be pressed into service by hundreds of tax-exempt professional and trade journals nationwide.

4. As noted in our petition (at 25-26), the decision below is the first by a court of appeals to consider the question presented here. Because the Claims Court is a court of nationwide jurisdiction, however, and because the tax-exempt press is a well-organized group that can be expected

to plan its litigation strategy circumspectly, we think it will prove difficult to develop a circuit conflict. We believe that the departure from even-handed administration of the tax laws required by the decision below is important enough — to the IRS, to Congress, and to respondent's taxpaying competitors in the marketplace — to warrant this Court's review.

For these reasons and for the reasons set forth in our petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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Acting Solicitor General

JUNE 1985

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No. 84-1737

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA,

Petitioner,

v.

AMERICAN COLLEGE OF PHYSICIANS,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF *AMICUS CURIAE* OF THE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

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BRIEF *AMICUS CURIAE* OF THE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

PRELIMINARY STATEMENT

The Amercian Society of Association Executives ("ASAE") submits this brief *amicus curiae* in opposition to the government's Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit. All parties to this suit have given ASAE written consent to the filing of this brief. Copies of such consents have been filed with the Clerk of this Court.

INTEREST OF AMICUS CURIAE

The American Society of Association Executives (ASAE) is a non-profit organization exempt from taxation under Section 501(c)(6) of the Internal Revenue Code. ASAE exists to promote the art and science of association management and to educate its

members and the general public in the advancement, improvement and uses of voluntary associations. The membership of ASAE is comprised primarily of full-time staff personnel engaged in the management of trade, professional, technical, educational, philanthropic or similar type organizations. ASAE has over thirteen thousand active members. ASAE has long been recognized as a leading speaker and advocate on association issues, particularly where, as in the present case, the ability of associations to function as educational and public spirited organizations is at stake.

A number of ASAE's 13,000 members are actively involved in managing associations that publish educational journals and many of these journals accept educational advertisements such as those which the Federal Circuit considered in *American College of Physicians*, below. ASAE also publishes several magazines that accept educational advertisements. ASAE's monthly publication *Association Management*, is read by thousands of association executives and contains numerous articles and advertisements on good management techniques, effective tradeshow strategies, membership needs, changes within various professions, disciplines and industry groups as well as relevant news on legal events concerning charitable and educational non-profit organizations.

Many association executives have been forced to forego the opportunity to assist their members in providing the most expansive and broad reaching educational information because of the restrictive interpretation of the non-profit advertising regulations used by the Internal Revenue Service. This interpretation has often been a factor in the decisions of many associations not to publish advertisements in their magazines and journals, even where it is clear that such advertisements would assist members in making intelligent choices and being more aware of issues and decisions with which they must deal in their work. ASAE believes that the decision of the Federal Circuit is one of a factual determination based on a clear statutory and regulatory meaning and that any further review would entail a review of a simple factual dispute and not, as is required under the rules of the United States

Supreme Court and applicable case law, a review of a question of law. A grant of certiorari in this case is unwarranted and would send a message to the government that whenever there exists a factual dispute as to the activities of an association, the way to resolve the problem is through a petition for a writ of certiorari to the United States Supreme Court. This would set a bad precedent.

ASAE believes that its experience as a non-profit organization leader and its insight into the issues on certiorari will prove helpful in this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

The present case involves no conflict among the several circuits; it involves no departure by a court from the accepted and usual course of judicial proceedings, nor does it contain an important question worthy of review by the Supreme Court of the United States. The decision below does no more than correct an erroneous factual analysis rendered by the United States Claims Court, and this cannot be the basis upon which a writ of certiorari to the Court of Appeals for the Federal Circuit will issue. To grant a petition for a writ of certiorari in this case would be to encourage resort by the federal government to the United States Supreme Court whenever a lower court renders a factual based decision with which a government agency is displeased.

The assertions of the United States with regard to certiorari do not meet the requirements of rule 17 of the United States Supreme Court. If the petition is granted in this case, the government will only argue that the facts of this case were wrongly interpreted by the Court of Appeals for the Federal Circuit. There is no need for this Court to review such a case.

I. NO "SPECIAL AND IMPORTANT REASONS" JUSTIFY THE GRANTING OF CERTIORARI

Recognizing that "review on writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefor . . . ," U.S.

Sup. Ct. Rule 17.1, the government seeks to persuade this Court that such reasons exist because the decision below has nationwide impact and because it conflicts with congressional intent. While it is true that the decision of the Federal Circuit Court of Appeals may have nationwide impact, such an impact accords with the purposes underlying the creation of that court and, in no way, demands review in this Court. Nor does the decision below conflict with congressional intent; indeed, the decision represents a faithful adherence to the considerations which gave rise to the enactment of Section 513(c).

1. As the government admits, the "decision below is the first by a court of appeals to consider the question presented here." (Petition for Certiorari at 25). Thus, it is clear that the question sought to be presented is not one which has given rise to conflicting decisions of the courts of appeal, nor does it involve issues which are of recurring importance in the administration of the tax laws. Under this Court's rules and decisions governing the granting of certiorari in tax cases, the existence of a conflict in the decisions of the courts of appeal or the presence of an issue which is of recurring importance in the administration of the tax laws, generally, is required before this Court will grant review on certiorari. *Bingler* v. *Johnson,* 394 U.S. 741 (1969); *United States* v. *Zacks,* 375 U.S. 59 (1963). This Court's own rule, governing review on certiorari, was amended in 1984 to provide that review of decisions of the United States Court of Appeals for the Federal Circuit would be controlled by the same considerations applicable to review of decisions of all other courts. U.S. Sup. Ct. Rule 17.2.

Nevertheless, the government attempts to argue that the very absence of a conflict in decisions requires the granting of certiorari. The government asserts, quite accurately, that the United States Claims Court is a court of nationwide jurisdiction and that any taxpayer can have its case heard there, with review in the Federal Circuit. The government goes on to state that, unless certiorari is granted, "the decision below will in all likelihood prescribe the governing legal standard on the subject [of taxation of advertising which appears in journals published by tax exempt organizations]." (Petition for Certiorari at 26).

In essence, the government is saying to this Court that certiorari must be granted because the government does not like the outcome below and that decision may become controlling law. A party's displeasure with a judicial decision cannot provide a legitimate basis for the granting of certiorari. Moreover, were this Court to concur with the government's argument, it would, effectively, eviscerate the power and authority of the Federal Circuit Court of Appeals. In every future instance in which the Federal Circuit decided an issue of first impression, if the government were displeased with the outcome, it could seek review in this Court solely on the basis that the Federal Circuit's decision had nationwide impact and application.

In creating the United States Court of Appeals for the Federal Circuit, Congress was mindful of two primary considerations. First, there was a perceived need "for the definitive adjudication of selected categories of cases" and for the creation of a "forum for appeals from throughout the country in areas of the law where Congress determines that there is special need for national uniformity." S. Rep. 97-275, 97th Cong., 2d Sess. 3-4 (1981), reported in 2 *U.S. Code Cong. & Ad. News* (1982) 13-14. Secondly, Congress recognized that this Court was "operating at — or close to — full capacity; therefore, in the future the Court cannot be expected to provide much more guidance in legal issues than it now does." *Id.* at 3. It was the express intent of Congress to create a court which could render decisions of nationwide application in certain areas of the law, which decisions would *not* have to be reviewed by this Court in order to achieve national uniformity. The government attempts to turn the intent of Congress on its head by asking this Court to create an automatic right of appeal to this Court from adverse decisions in the Court of Appeals for the Federal Circuit.

In the absence of a conflict between a decision of the Federal Circuit and the decisions of other courts of appeal, there can be no compelling reason for this Court to review the decision of the Federal Circuit.

2. This case does not present an issue of recurring importance in the administration of the tax laws. The court of appeals

did not overrule or give an unusual construction to any statute. The court merely reviewed the trial court's decision and reversed it on a finding that the trial court's analysis of the facts of the case was clearly erroneous. In so doing, the court merely held that the respondent's journal's advertising was "substantially related" to the respondent's exempt educational function. This is the test set out in the statute. Since the court of appeals did not in any way overrule or modify this statutory test, its decision can occasion no "issue which is of recurring importance in the administration of the tax laws."

II. THE GOVERNMENT IS MERELY ASKING THIS COURT TO REVIEW THE APPEALS COURT'S FACTUAL DETERMINATION

The government states that the court of appeals has decided "an important question of federal tax law" in a way that conflicts with congressional intent (Petition at 8). This is not the case. The court of appeals stated the statutory and regulatory standards and reviewed the finding of the lower court that the advertising in the College's journal did not meet the "substantially related" test. The court of appeals " . . . conclude[d] that the trial court's finding that the advertising in *Annals* is not substantially related to the College's tax-exempt, educational purpose, was clearly erroneous." (Petition App. A at 19a). The court of appeals correctly stated the rule of law embodied in sec. 513(c) and the regulations thereunder. The court of appeals, in applying that rule of law to the facts before it on review, simply decided that the trial judge's analysis of the facts was clearly erroneous.

The court of appeals' decision turned on the facts presented in that particular case. The fact that the court of appeals found that the advertising contained in the College's journal met the "substantially related" test of Section 513 in no way implies or necessitates that henceforth all other courts must find that advertising in any other journal published by a tax-exempt entity meets the statutory test, unless this Court intervenes. Since the court of appeals' decision rests on its review of the facts peculiar to the case before it, all that this Court would accomplish in granting the petition for certiorari would be to review the specific facts in

the *American College of Physicians* case. Such a review would do nothing to guide courts in making future decisions as to whether different facts in different cases met the "substantially related" test of Section 513(c).

Thus, contrary to what the government's petition would have this Court believe, the court of appeals decided no new question of law; it merely made a factual determination, which there is no good reason for this Court to disturb. We do not address the statutory construction by the appellate court, since the court considered this to be a factual case of "substantially related" activity.

III. THE COURT SHOULD NOT GRANT REVIEW ON THE BASIS OF "ADMINISTRATIVE CONVENIENCE"

The government asserts that certiorari should be granted because the question sought to be presented is of "administrative importance" and because the Federal Circuit's decision will "impose formidable burdens on IRS audit resources." (Petition at 22 and 24). In other words, the government claims that it will be administratively inconvenient for the Internal Revenue Service to comply with the Federal Circuit's interpretation and application of the statute and the regulations.

The government claims that the "revenue impact of the decision below would likewise be substantial," (Petition at 23), but the statistics which are used to support this claim are incomplete and misleading. The government relies on 1981 figures to establish the total number of trade journals in existence and their total advertising revenues but utilizes 1969 figures to establish the number of trade journals published by tax-exempt organizations. Of course, none of these figures assist this Court in estimating the revenue impact of the decision below. Published statements from the Department of Treasury do, however, provide some insight into the magnitude of the revenue impact.

According to a recent study by the Small Business Administration, the total revenues collected under the unrelated business income provisions in FY 1982 were $24,600,000. Of that amount, only a portion is attributable to taxes levied on the advertising

income of journals published by nonprofit organizations. Even if the government's concern, that the taxes collected on such advertising income will diminish, is correct, the loss of some portion of $24,600,000 in taxes hardly can be deemed as a "substantial" impact on revenue when the Internal Revenue Service collected more than $680,000,000,000 in 1984.

The government also contends that the IRS will suffer "formidable burdens" on its audit resources because the taxability of the advertising income of exempt organizations will now have to be addressed on a case-by-case basis. As the Court is aware, however, there are numerous provisions in the Internal Revenue Code which require analysis on a case-by-case basis.

According to the government, in the past the IRS has utilized a "presumption" that advertising income of tax-exempt organizations was taxable, despite the fact that the statute neither states that nor implies it; indeed, the regulations drafted by the IRS make it clear that not all such advertising revenue is taxable. While it may be "administratively convenient" for the IRS to utilize such a presumption, administrative convenience does not justify the improper application and enforcement of the revenue laws. "The agency charged with implementing the statute is not free to evade the unambiguous directions of the law merely for administrative convenience." *Brown* v. *Harris*, 491 F. Supp. 845, 849 (N.D. Cal. 1980), citing *Manhattan General Equipment Co.* v. *C.I.R.*, 297 U.S. 129, 134 (1936).

If the government truly believes that the revenue impact of the Federal Circuit's decision is substantial or that the burden on the audit resources of the IRS is significant, then the appropriate forum for voicing those concerns is in the United States Congress, not this Court.

CONCLUSION

For all of the foregoing reasons, your amicus respectfully submits that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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No. 84-1737

IN THE
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UNITED STATES OF AMERICA,
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Respondent,

MOTION FOR LEAVE TO FILE AND BRIEF FOR AMERICAN BUSINESS PRESS AS AMICUS CURIAE IN SUPPORT OF PETITION OF THE UNITED STATES FOR A WRIT OF CERTIORARI

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AMERICAN COLLEGE OF PHYSICIANS,

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF PETITION OF UNITED STATES FOR A WRIT OF CERTIORARI

American Business Press (ABP) respectfully moves for leave to file the attached brief Amicus Curiae in support of the petition for a writ of certiorari of the United States in the instant proceeding.

The consent of counsel for the petitioner has been obtained. The consent of counsel for respondent was requested by letter and orally. On May 28, 1985 counsel for respondent informed counsel for ABP that respondent would not grant consent.

ABP is a publishers' association of well over 500 scientific, professional, and technical periodicals. ABP

member companies include, *inter alia,* Broadcasting Publications, Inc. (Washington, D.C.), Cahners Publishing Co. (Boston), Chilton Company (Philadelphia), Harcourt Brace Jovanovich Publications (Cleveland), Hearst Business Publishing (New York), International Thomson Communications, Inc. (Denver), Lakewood Publications, Inc. (Minneapolis), McGraw-Hill, Inc. (New York), Miller Freeman Publications (San Francisco), Pennwell Publishing Co. (Tulsa), Public Utilities Reports, Inc. (Arlington, Va.), Technical Publishing (New York and Barrington, Illinois) and Vance Publishing Corp. (Chicago). All members of ABP are for-profit, taxpaying publishing companies.

ABP was an active participant both in administrative hearings preceding the adoption of the 1967 Treasury Regulations which are at the heart of this case (Treas. Reg. 1.513-1 *et seq.*) and in the Congressional hearings preceding passage of the Tax Reform Act of 1969. That statute augmented the Unrelated Business Income Tax (UBIT) passed in 1950 and gave the 1967 regulations the force of law as explained in the attached *amicus* brief.

Passage of the UBIT and the 1969 statute was intended to protect taxpayers from unfair competition from businesses operated by tax-exempt organizations. The decision of the United States Court of Appeals for the Federal Circuit in *American College of Physicians* v. *United States,* 743 F.2d 1570 (1984), if allowed to stand, would nullify the express intent of Congress to apply UBIT to unrelated business income on advertising and similar activities earned by Respondent and others.

In October, 1984, ABP filed an *Amicus Curiae* Brief in support of the United States' Moton For Rehearing *En Banc* in the Federal Circuit case, *supra,* because of ABP's

grave concern about the destructive national effect that decision would have on enforcement of the UBIT.

ABP's interest herein is consistent with its past advocacy of fair competition as embodied in the UBIT. It is that Congressionally sanctioned principle which the Federal Circuit opinion below would destroy and which necessitated the petition of the United States and the Amicus Curiae brief of ABP.

WHEREFORE, ABP respectfully moves that its Motion For Leave to file Brief Amicus Curiae in Support of Petition of United States For a Writ of Certiorari be granted.

Respectfully submitted,

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QUESTION PRESENTED

Whether income derived by a tax-exempt medical association from the sale of commercial advertising space in its monthly journal is "unrelated business income" subject to tax under Sections 511 through 513 of the Internal Revenue Code.

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BRIEF FOR AMERICAN BUSINESS PRESS AS AMICUS CURIAE IN SUPPORT OF PETITION OF THE UNITED STATES FOR A WRIT OF CERTIORARI

INTEREST OF AMICUS CURIAE AMERICAN BUSINESS PRESS

American Business Press (ABP), files this amicus curiae brief in support of the petition of the United States for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in *American College of Physicians* v. *United States*, 743 F.2d. 1570 (1984).

ABP is the nation's association of trade journal publishers. Its members publish over 500 scientific, profes-

sional, educational and other types of specialized periodicals circulated within the United States and throughout the world. In a wide variety of fields of endeavor for which the ABP members edit publications, there are competing periodicals issued by tax-exempt organizations. The following table shows examples of this head-to-head competition:

Tax Exempt	Taxpaying
Builder (National Association of Home Builders)	*Building Design & Construction* (Cahners Publishing Co.)
Chemical & Engineering News (American Chemical Society)	*Chemical Engineering* (McGraw-Hill, Inc.)
IEEE Spectrum (Institute of Electrical and Electronic Engineers)	*Electronic Design* (Hayden Publishing Co.)
Journal of Petroleum Technology (American Institute of Mining, Metallurgical and Petroleum Engineers)	*Oil & Gas Journal* (Pennwell Publishing Co.)
Nations Business (U.S. Chamber of Commerce)	*Industry Week* (Penton/IPC)
Science 85 (American Association for the Advancement of Science)	*Science Digest* (Hearst)

Many other examples could also be cited.

SUMMARY OF ARGUMENT

The issue before this Court is whether the Unrelated Business Income Tax (UBIT) passed by Congress in 1950

as amended in 1969 is to be overthrown by an ill-considered decision of the Federal Circuit.

The Federal Circuit's opinion is a prime example of judicial usurpation of the taxing power of Congress. It is an opinion so erroneous on its face as to exclude any mention whatsoever of the administrative agency regulation which had specifically been validated and given the force of law by Congress in 1969, 26 U.S.C. § 513(c). Neither the actions of the IRS or Congress made any difference to the Federal Circuit.

In the case at bar, unless this Court grants the petition of the United States so as to review the havoc that has been wrought and would be wrought if the Fedeal Circuit decision stands, unfair competition will flourish: *Today* it is advertisements appearing in *Annals* published by respondent in direct competition with taxpaying publishers. If the advertising proviso with all its legislative history falls, then *tomorrow* UBIT itself is in jeopardy.

This is no narrow issue limited to respondent and its *Annals*. The very regulation so glaringly ignored by the Federal Circuit contains an example (Example 7) which precisely describes respondent (*see* Government Petition, p. 51a). That regulation declared the advertising profits of respondent taxable. Congress then validated those regulations through the passage of 26 U.S.C. §513(c) in 1969, expressly stating that it was giving the IRS advertising regulations the force of law.

Chief Claims Court Judge Kozinski enforced the IRS Regulations and the Act of Congress by declaring the advertising profits of the respondent taxable. The Federal Circuit gave no respect whatsoever to the lengthy legislative history in which Congress explained why it passed not only UBIT, but also Section 513(c), wherein Con-

gress specifically indicated its clear intention that advertising, *all* advertising, is not a purpose for which *any* organization was granted tax exemption.

If ever a case cries out for appellate correction of judicial error, this is that case.

There is impact of deep national significance in this case because it bears so importantly on unfair competition by tax-exempt organizations with taxpayers, entirely apart from the complete disregard the Federal Circuit has demonstrated for both the Treasury Regulations and the Congress of the United States by its usurpation of their power. Moreover, if the tax system is to be fair, it cannot be construed to exempt identical commercial activity A and tax identical commercial activity B without causing disrespect for the tax system, as well as loss of tax revenues resulting from so discriminatory a practice.

ARGUMENT

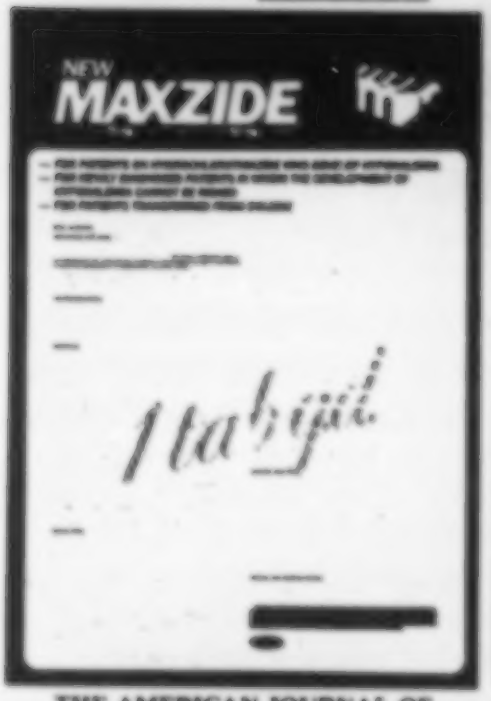
I. The UBIT Was Enacted to Preclude the Kind of Unfair Competition That Tax-Exempt Publishers Like Respondent Wage Against Taxpayers

The pictures on the facing page demonstrate more graphically than words what this case is all about. The advertisements for Maxzide, a prescription drug manufactured by Lederle, reproduced here in reduced size and in black and white, appeared in full color in more than 25 publications including the following:

Annals of Internal Medicine (Annals), published by American College of Physicians (ACP) a nonprofit §501(c)(3) organization, respondent in case at bar.

MAXZIDE IN TAX-EXEMPT AND TAXPAYING PERIODICALS

ANNALS OF INTERNAL MEDICINE
JANUARY 1985 (TAX EXEMPT)



THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION
FEBRUARY 8, 1985 (TAX EXEMPT)

THE AMERICAN JOURNAL OF MEDICINE
MARCH 1985 (TAX PAYING)

MEDICAL ECONOMICS
MARCH 4, 1985 (TAX PAYING)

BEST AVAILABLE COPY

The American Journal of Medicine, published by Technical Publishing Company, a subsidiary of taxpaying Dun & Bradstreet.

The Journal of the American Medical Association, published by AMA, a nonprofit §501(c)(6) organization.

Medical Economics, published by the taxpaying International Thomson Business Press.

Since 1950, courts on many occasions have reemphasized the primary UBIT purpose of preventing unfair competition. The Fifth Circuit in *Louisiana Credit Union League* v. *United States*, 693 F.2d 525, 539 (1982) held:

> A fair reading of the legislative history of the Revenue Act of 1950 indicates that Congress indeed was concerned that exempt institutions choosing to enter the market place would enjoy an unfair advantage over their taxpaying competitors. See H.R. Rep. No. 3219, 81st Cong., 2d Sess., reprinted in 1950-2, C.C. 380; S. Rep. No. 2375, 81st Cong., 2d Sess., reprinted in 1950-2 C.B. 483; 96 Cong. Rec. 9351, 9366 (1950) (statement of Mr. Lynch). *Congress reiterated its interest in preventing unfair competition when section 513 was amended in 1969.*[11] Similar language accompanied further amendments in 1978. [Footnotes omitted and emphasis supplied]

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[11]The 1969 amendment to UBIT referred to in *Louisiana Credit Union* was enacted primarily to deal with advertising in tax-exempt periodicals, particularly in medical journals. This is the Congressional enactment before the Court in the case at bar.

In *Hope School* v. *United States*, 612 F.2d 298, 303 (1980), the Court of Appeals for the Seventh Circuit said that unfair competition is "the primary consideration" when a court determines whether a tax exempt organization is conducting an unrelated trade or business.

The Second Circuit and the Sixth Circuit like the Fifth and Seventh Circuits have also declared that the purpose of Congress in extending the income tax to the unrelated business income of tax-exempt organizations was to eliminate the unfair competitive advantage over taxpayers that tax-exempt organizations like respondent enjoy when they engage in an unrelated trade or business. *Rensselaer Polytechnic Institute* v. *Commissioner of Internal Revenue*, 732 F.2d 1058, 1061 (2d Cir. 1984); *Service Bolt and Nut Co.* v. *Commissioner of Internal Revenue*, 724 F.2d 519, 524 (6 Cir. 1983).

II. The Federal Circuit Decision Frustrates the Clear-cut Purpose of the 1969 UBIT Amendment As Recognized At The Time Of Its Adoption by Friend and Foe Alike

The Government's petition sets forth the legislative and regulatory history of the UBIT and its application to advertising, specifically medical advertising. As the petition indicates, after the Treasury issued regulations in 1967, (Treas. Reg. 1.513-1, 32 Fed. Reg. 17657 (1967)) a wave of anguish arose from tax sanctuary publishers, including respondent, AMA, and tax-exempt organizations not wishing to pay any tax on their advertising profits.

In the 1969 Congressional hearings, ABP as well as other taxpaying organizations and publishers like the National Newspaper Association, Second Class Mail Publications, Inc., the Agricultural Publishers Association, Fair-

child Publications, Atlantic Monthly, McGraw-Hill, and others testified in favor of the 1967 Treasury Regulations. The taxpaying press urged that the pending tax reform legislation before Congress be adopted because it reduced unfair competition by treating both taxpaying and non-taxpaying competitors alike.

It is significant in the case at bar that in the 1969 hearings before the House and Ways and Means Committee, the spokesman for respondent was the same Dr. Edward Rosenow who testified in the Claims Court before Judge Kozinski in 1983. In 1969, Dr. Rosenow testified:

> We believe that the broad sweep of the new regulations is too big because purely educational organizations are caught up with noneducational organizations. The new Treasury regulations have the effect of *conclusively presuming that advertising income derived from the college's publication constitutes taxable unrelated trade or business income.* [Emphasis supplied][2]

Hearings on Tax Reform, 1969, before the House Ways and Means Committee, 91st Cong., 1st Sess., pt.4, at 1113.

Dr. Rosenow argued that advertising in *Annals* had an educational value justifying tax exemption, and that it contributed importantly to the tax-exempt purpose of the respondent. *Id.* at 1111-1113.

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[2]By the time 1983 rolled around the respondent had rolled around too, 180° around, Congress to the contrary in 1969 notwithstanding. Respondent told Judge Kozinski that advertising was related, contributed importantly its tax-exempt function, was educational, and was not subject to income tax. It is as though IRS never issued any regulations, that Dr. Rosenow had not testified 180° differently, and that Congress had never *rejected* respondent's arguments.

Before the same Ways and Means Committee, counsel for AMA testified:

> [I]n the typical case taxation of the advertising income of tax-exempt publications under the new regulations will effectively deny these publications tax exemption. * * * The apparent philosophy behind these new advertising regulations is to discard the test of relatedness and to tax exempt organizations on the basis that their publications compete with those published by commercial publishers. *Hearings on Tax Reform, 1969, before the House Ways and Means Committee, 91st Congress, 1st Sess., p. 1260.*

The American Association of Petroleum Geologists stated that the Regulations would "declar[e] that all such advertising income is *per se* unrelated business income." *Id.* at 1379.

The Association for Childhood Education International said that the Regulations "would ha[ve] the effect of establishing a *conclusive presumption* that any advertising carried in a tax-exempt organization's periodical is unrelated for the purposes of determining the taxability of income therefrom." *Id.* at 1412. [Emphasis supplied]

The parade of witnesses desiring to conduct tax exempt business also included spokesmen for the Society of National Association Publications, the United States Chamber of Commerce, the American Chemical Society, the American Society of Association Executives, the Institute of Electric and Electronics Engineers, the American Geological Institute, and an assortment of others.

But Congress expressly *rejected* Dr. Rosenow's arguments against the Regulations and those of the other opponents of UBIT: The House Ways and Means Commit-

tee, the Senate Finance Committee, the House of Representatives and the Senate voted that *all* advertising in tax-exempt periodicals is an exploitation[3] of the tax-exempt function of nonprofit organizations, and that profits earned thereon are subject to income tax for respondent, just like everybody else.

Both Houses of Congress issued reports which declared advertising income taxable, regardless of the publisher's identity or profession, regardless of whether the organization was classified 501(c)(3) or 501(c)(6), or any other 501 classification.

Thus, following House Committee hearings on the 1967 Treasury Regulations, the Ways and Means Committee issued a report on H.R. 13270, H. Rep. No. 91-413. This report stated that the regulations were consistent with Congress' original purpose in enacting the UBIT, and that the regulations were valid. And because of the controversy over them, Congress decided to give them the force of law. The report states:

> Because of the ensuing controversy over this problem *your committee has decided to deal with this subject by legislation*. In general, it is in agreement with the purpose of the regulations. Your Committee believes that a business competing with taxpaying organizations should not be granted an unfair competitive advantage by operating tax free unless the business contributes importantly to the exempt function. It has con-

[3]It works this way: If the publishing of editorial content in a tax-exempt organization's periodical is a related, tax-exempt function, then the sale of advertising in that same periodical is exploitation of the exempt (editorial) function and the profits earned on that advertising are taxable. The Treasury Regulations so provide, and Congress enacted those regulations into law in 26 U.S.C. § 513(c).

> cluded that by this standard, *advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and* therefore it believes *that this income should be taxed.* [Emphasis supplied]

2 U.S. Cong. and Admin. News 1695 (1969)

Elsewhere in the same report, the Committee explained the reasons why it was amending §513 of the Tax Code by adding a new subsection (c) entitled *"Advertising, etc., activities"* which would apply to *all* advertising, including *medical advertising* like that contained in *Annals*. The report states:

> Finally, the Internal Revenue Service promulgated regulations on December 12, 1967 which clarified the law with respect to the conduct of an unrelated trade or business carried on as part of an exempt function. *This regulation mainly affected the advertising income of publications such as medical journals.* There has been controversy over the validity of these regulations. *Your committee wants to make it clear that such regulations are valid.* [Emphasis supplied]

Id. at 1690.

After Senate hearings, Senate Finance Committee Report No. 91-552 similarly explained the purpose of the amendments to §513 of the Tax Code, particularly subsection (c), entitled "Advertising, etc., activities". The Senate Report states:

> Present law. — In December 1967, the Treasury Department promulgated regulations under which the income from advertising and similar activities is treated as 'unrelated business income' even though such advertising for example may

> appear in a periodical related to the educational or other exempt purpose of the organization.
>
> General reasons for change. — The Committee agrees with the House that the regulations reached an appropriate result in specifying that when *an exempt organization carries on an advertising business in competition with other tax-paying businesses, it should pay a tax on the advertising income.* The statutory language [the 1950 Act] on which the regulations are based, however, is sufficiently unclear so that substantial litigation could result from these regulations. For this reason, *the committee agrees with the House that the regulations, insofar as they apply to advertising and related activities, should be placed in the tax laws.* [Emphasis supplied]

Id. at 2104.

One thing comes through loud and clear from the 1969 Congressional hearings. *All* who testified knew if the law passed, that advertising would not qualify as a tax-exempt activity, that it was not related to any tax-exempt purpose, and that it did not contribute importantly to any tax-exempt purpose.

In *First National Bank* v. *Walker Bank & Trust Co.*, 385 U.S. 252, 261 (1966) this Court was called upon to interpret legislation which, like UBIT, was enacted to further "a policy of competitive equality." Maintenance of competitive equality has vast national significance and impact, involving not only fair competition, but in the case of UBIT and §513(c) the very integrity of and respect for the tax system itself.[4] In *Walker*, this Court held:

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[4]The national policy of tax-free advertising which would follow the Federal Circuit's decision would cause a scoffing at and disrespect for the nation's income tax laws because advertising by its very nature is

> *It is not for us to construe the Acts as to frustrate this clear-cut purpose so forcefully expressed by both friend and foe of the legislation at the time of its adoption.* To us it appears beyond question that Congress was continuing its policy of equalization first adopted in the National Bank Act of 1864. [Emphasis supplied].

In the 1969 Congressional hearings on the Treasury Regulations there was no dispute by either side over the meaning of the regulations. The record clearly shows that respondent told Congress it would have to pay a tax if the legislation passed. Respondent's tax-paying competitors told Congress that it was unfair competition for the same advertisement to appear in a taxpaying periodical and a tax-exempt periodical without equal tax applying to that same advertisement *wherever* it appeared.

Incredibly in 1984, *15 years after the 1969 UBIT legislation*, the Federal Circuit, overruling the considered opinion of Chief Judge Kozinski, substituted its views for the policy decision which Congress made in the Tax Reform Act of 1969, and declared Congress to be ignorant of its own purposes when it applied the UBIT to advertising.

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so flagrantly commercial that it cannot be tax-exempt without subjecting the tax system to ridicule. This device can also be applicable to other types of activity once respondent's nose in this camel's tent is applied to a myriad of other exploitable tax-exempt functions.

III. The Federal Circuit Decision Not Only Invalidated Long Standing Treasury Regulations Which of Themselves Were Entitled to Great Weight But Also Disregarded the 1969 Congressional Codification of the Treasury Regulations

"When faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the agency charged with its administration." *Unemployment Compensation Commission* v. *Aragon,* 329 U.S. 143, 153 (1946); *Udall* v. *Tallman,* 380 U.S. 1, 16 (1965); *Zenith Radio Corp.* v. *United States,* 438 U.S. 443, 450 (1978); *Ford Motor Credit Co.* v. *Cenance,* 452 U.S. 155, 159 (1981).

In the instant case the Court of Appeals ignored not only the language of section 513(c) of the Revenue Code and the legislative history of the 1969 enactment of section 513(c), it compounded its error by invalidating *sub silentio* the 1969 Treasury Regulations, including Example 7 which fits exactly respondent's conduct of an advertising business in exploitation of *Annals* editorial content.[5] In the process, the Court of Appeals closed its eyes to the force of law which Congress expressly gave the 1967 Treasury Regulations on advertising when it enacted the Tax Reform Act of 1969.

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[5]Treasury Regulation 1.513-1(iv) reproduced at p.50(a) of the Government's petition precedes Example 7 which appears at p. 52.(a) therein, Example 7 *modifying* Section (iv). Section (iv) taxes exploitation of exempt functions for commercial purposes unless the commercial activity contributes importantly to the accomplishment of an exempt purpose. *Example 7 then proceeds to hold that advertising in a journal containing editorial content like that in ACP's Annals does not contribute importantly to the accomplishment of any exempt purpose and the income from that advertising is taxable as unrelated trade or business.*

IV. Since the United States Court of Appeals for the Federal Circuit Is a Court of National Jurisdiction Its Decision in the Case At Bar Unless Ultimately Reversed Will Make That Court a Tax Haven Not Only For Respondent But For a Wide Number of Nonprofit Organizations Which Conduct Tax-Exempt Businesses Which Compete With Taxpayers

As the Government correctly points out in its petition (p. 25), one urgent reason this case has nationwide impact is because the Federal Circuit is a court of nationwide jurisdiction: the Federal Circuit will become a tax haven not only for respondent and other medical associations, but also for all manner of non-profit organizations which will claim that advertising published in their journals is "educational", or "contributes importantly to their tax-exempt purpose", or is "related" to their tax-exempt purpose. They will claim that their advertising is therefore tax-exempt, notwithstanding the fact that Congress voted repeatedly and specifically in 1969 to declare advertising in general, and medical advertising in particular, unrelated to any tax-exempt purpose and therefore subject to UBIT.

IRS presently has at least 200 unrelated business income tax cases with various nonprofit organizations. (Government's petition, p. 23) A flood of tax refund claims into the Federal Circuit by these and other nonprofit organizations will be a certainty unless this Court overturns the error of the Federal Circuit.[6]

Significantly, the ink on the decision in respondent's case was hardly dry before the American Medical Associa-

[6]The May 13, 1985 issue of the "Non-Profit Organization Tax Letter", a newsletter the title of which is self-explanatory, cites a recent statement by IRS Commissioner Egger that there are 871,000 exempt organizations, of which 353,000 are charitable organizations and 53,000 are "business leagues".

tion indicated that it plans to dismiss the UBIT advertising tax refund claims it previously filed and which are now pending in the Northern District of Illinois (Civil Action No. 82-C-7213, filed November 23, 1982). This action would clearly be the first step in moving AMA's claims into the Federal Circuit. (*See* p. 25 of the Government's Petition.)

Moreover, in its answer opposing ABP's Motion to Intervene in the *AMA* case in Chicago, the American Medical Association doctors cited the instant decision affecting the doctors in the American College of Physicians as the law of the land, justifying non-payment of taxes by AMA on its advertising income. The AMA answer to ABP's motion in the Chicago case states:

> Because the Federal Circuit reviews all decisions of the Claims Court regarding income tax refund claims, and because the Claims Court is available to all taxpayers who wish to file a refund claim, the *American College* decision, not any decision in this case, effectively establishes the law with respect to the 'relatedness' issue.

Memorandum of AMA in Opposition to Motion of ABP for Leave to Intervene, March 25, 1985, p. 11.

For purposes of the UBIT there can be no difference between AMA doctors and respondent's doctors. In fact, their memberships considerably overlap.[7]

The revenue impact of the *ACP* decision will be heavy. In the Chicago litigation, AMA witness Thomas Hannon,

---

[7]Respondent is a § 501(c)(3) organization, AMA is a § 501(c)(6) organization. Theoretically 501(c)(3) can not lobby, whereas 501(c)(6) can. But advertising in *The Journal of the American Medical Association*, respondent's *Annals*, and in journals published by their taxpaying competitors is identical.

Executive Vice President for Corporate Publishing and Management Services of AMA, like respondent in this case, admitted in depositions and interrogatories that AMA's medical publications compete for substantial advertising revenues with taxpaying publishers, including members of ABP. Mr. Hannon at p. 15 of his deposition (May 30, 1984) stated:

> *The 20 leading pharmaceutical companies in the country that represent the largest share of advertising in the medical field* literally run in 'Medical Economics' [an ABP member publication] and *our* [AMA] publications, almost all of them. [Emphasis supplied]

According to recent responses filed by AMA in the same case, AMA had $13,189,298.00 of unrelated business income between 1975 and 1978, the years at issue in that case. Unless *ACP* is reversed, the amounts will be much greater for subsequent years for respondent, for AMA, for all nonprofit medical publications, and for all tax-exempt journals generally. Certainly this is no time for the Federal Circuit to *open* tax loopholes, particularly loopholes Congress closed in 1950 and 1969.

If the Internal Revenue Service is required to read every advertisement in every nonprofit periodical in order to make the ad-by-ad determination accurately forecast by the Goverment in its petition (p. 24), administration of the UBIT would cease for all practical purposes and enforcement of the explicit directive of Congress would wither away.

CONCLUSION

Congress knew exactly what it was doing when it proscribed exploitation of exempt functions by tax-exempt organizations and applied this prohibition across the board. It was not a ukase applying to all tax-exempt organizations *except* the *Annals* of the American College of Physicians, as respondent would now have this Court believe. There is no exception in the UBIT for respondent or anyone else.

As this Court said in *First National Bank, supra,* "It is not for us to frustrate this clear-cut purpose so forcefully expressed by both friend and foe alike at the time of its adoption". Yet that is what the Federal Circuit did.

WHEREFORE, ABP respectfully requests the Court to grant the Government's petition for a writ of certiorari.

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(202) 638-4485

June 5, 1985

APPENDIX A

AFFIDAVIT OF JOHN K. ABELY IN SUPPORT OF MOTION OF AMERICAN BUSINESS PRESS FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF SUGGESTION OF UNITED STATES FOR REHEARING EN BANC

IN THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

APPEAL NO. 84-715

THE AMERICAN COLLEGE OF PHYSICIANS
Appellant

v.

THE UNITED STATES
Appellee

STATE OF NEW YORK)
) SS
COUNTY OF NEW YORK)

I, John K. Abely, being duly sworn, depose and say:

1. That I am President of Technical Publishing Co., an independent division of the Dun and Bradstreet Corporation. I have been professionally engaged in publishing for 27 years.

2. Technical publishes 21 medical, technical and business periodicals. These include the *American Journal*

of Cardiology, the *American Journal of Medicine,* the *American Journal of Surgery* and *Cutis* (a journal publishing clinical articles in dermatology), which comprise the Yorke Medical Group of Technical Publishing. All of our publications are published for-profit and are tax-paying journals.

3. Other periodicals published by Technical include *Dun's Business Monthly, Datamation, Plant Engineering* and *Solid State Technology And Research and Development.*

4. I have read the decision of the United States Court of Appeals for the Federal Circuit in *American College of Physicians* v. *United States,* slip op. no. 84-715. I am shocked by the conclusion in the Court's Opinion that the commercial advertising in the *Annals of Internal Medicine* should be tax-exempt. This decision, in my opinion, gives publishers of non-profit journals, which compete with tax-paying periodicals, a green light to again engage in unfair competition with us and other publishers.

5. At Technical, and I know I reflect the view of the 500 specialized tax-paying periodicals which belong to the American Business Press, we thought the issue of the unrelated business tax had been put to rest in 1969 when Congress specifically applied the unrelated business tax to advertising. Now to my amazement, the Court has said our competitors do not have to pay taxes on their advertising profits, because the advertising in *Annals* is allegedly related to the tax-exempt function of the owners of *Annals.* (slip op. at 18).

The same type of advertising appearing in *Annals* appears in our *American Journal of Medicine* and other medical periodicals. Each of our four medical journals

limits the type of advertising in the same manner as *Annals*. Each of our journals has a distinguished board of doctors who provide peer review as does *Annals*. From time to time, the same doctors who provide peer review for *Annals*, perform the same function for our medical journals.

The advertisements carried both in *Annals* and our journals do not announce new developments alone, but are printed month after month, as is the case with most commercial advertising, in order to make it effective.

Advertisements are aggressively solicited by salesmen representing the American College of Physicians. These solicitations are made to pharmaceutical manufacturers and to their advertising agencies. Out on the street the battle is for a share of an advertiser's budget: there may not be enough to place the same advertisement in both *Annals* and one of our journals. Advertisements published in *Annals* are sold at comeptitive rates in *Annals* and in our journals: the difference is that if this decision is upheld, *Annals* will not have to pay taxes on its advertising profits, but we will. This is unfair competition.

6. On February 25, 1969, when Congress held hearings on the unrelated business tax, Congress was particularly concerned with application of the tax to advertising in non-profit journals like *Annals*. Ralph Hench, then President of our medical publications, testified before the House Ways and Means Committee in support of the IRS regulations of 1967 which applied the unrelated business tax to advertising profits of nonprofit journals like *Annals*. He emphasized the unfair competition that his competitors like the *AMA Journal* and *Annals* were able to mount against him by virtue of their tax exemption.

7. I note that Dr. Edward Rosenow, Executive Director of *Annals*, appeared in the same hearing as Mr. Hench. And I further note that Congress ruled as Mr. Hench and others thought and not as Appellant and other would-be tax avoiders urged.

Nothing has happened in the last 15 years in the world of medical publishing to make the testimony of Mr. Hench any less relevant: if anything, there has been a proliferation of medical journals – some nonprofit, some for-profit. All of them are fiercely battling in a competitive marketplace for the medical advertising dollar. There should be no unfair tax advantage to any.

8. The reason why pharmaceutical companies advertise in medical journals is because they want to sell their products to readers who are in a position to buy their products. This is true of *Annals,* of our own journals and of all other journals that carry advertising. Let's face it: The purpose of advertising is to sell products. If *Annals* does not agree with this, it has a clear option: Let it provide its advertising without charge. Then there would be no income and therefore no tax.

9. I attach as Attachment 1 an advertisement *Annals* bought and paid for in *Medical Advertising News.* The purpose of this advertisement is to solicit additional advertising for *Annals.* Appropriately, *Annals'* advertisement is entitled "The Bottom Line," a financial term, not a term usually associated with nonprofit organizations. The advertisement gives both the names and telephone numbers of *Annals'* "sales representatives." It strikes me as anomalous that an organization exempt from Federal taxation has "sales representatives."

10. *Annals* has a sister tabloid publication published by the same nonprofit organization. Its title is *"The*

Observer." Annals conducts a joint advertising campaign with *The Observer.* Attachment 2 is an advertisement urging advertisers to advertise in both periodicals. I note that the advertisement states "Plan on scheduling *ACP Observer* and *Annals* to cash in on the clout of the stellar Journal/Tabloid Team." The emphasis is on "cash[ing] in." How is "cashing in on the clout" of any tax-exempt organization related to any tax-exempt purpose?

11. Back issues of *Annals,* upon request, are bound into volumes. When so bound, the advertising pages are deleted because, according to *Annals,* these pages are "extraneous material." (*Annals,* March 1983, p. I-117). That *Annals* follows this practice is further proof that the true purpose of *Annals'* advertising is to make money for the doctors who make up the ownership of the periodical.

12. If the three-judge panel's decision in this proceeding is upheld, its effects will be widespread, going far beyond the medical publishing field. All types of nonprofit journals will claim their advertising is "substantially related" to their tax-exempt purpose. We heard all these arguments in 1969 when we testified before Congress. Congress turned those arguments down, but unfortunately, the three-judge panel now has opened up a loophole for tax-exempt advertising and unfair competition. Trade associations, universities, professional societies and others which publish journals will even more aggressively market their journals to advertisers to take competitive advantage of the Court's Opinion.

In the meantime, journals like our *American Journal of Medicine* which pays taxes, will have to compete for the same advertising dollars as the *Annals of Internal Medicine.*

/s/ John K. Abely
John K. Abely

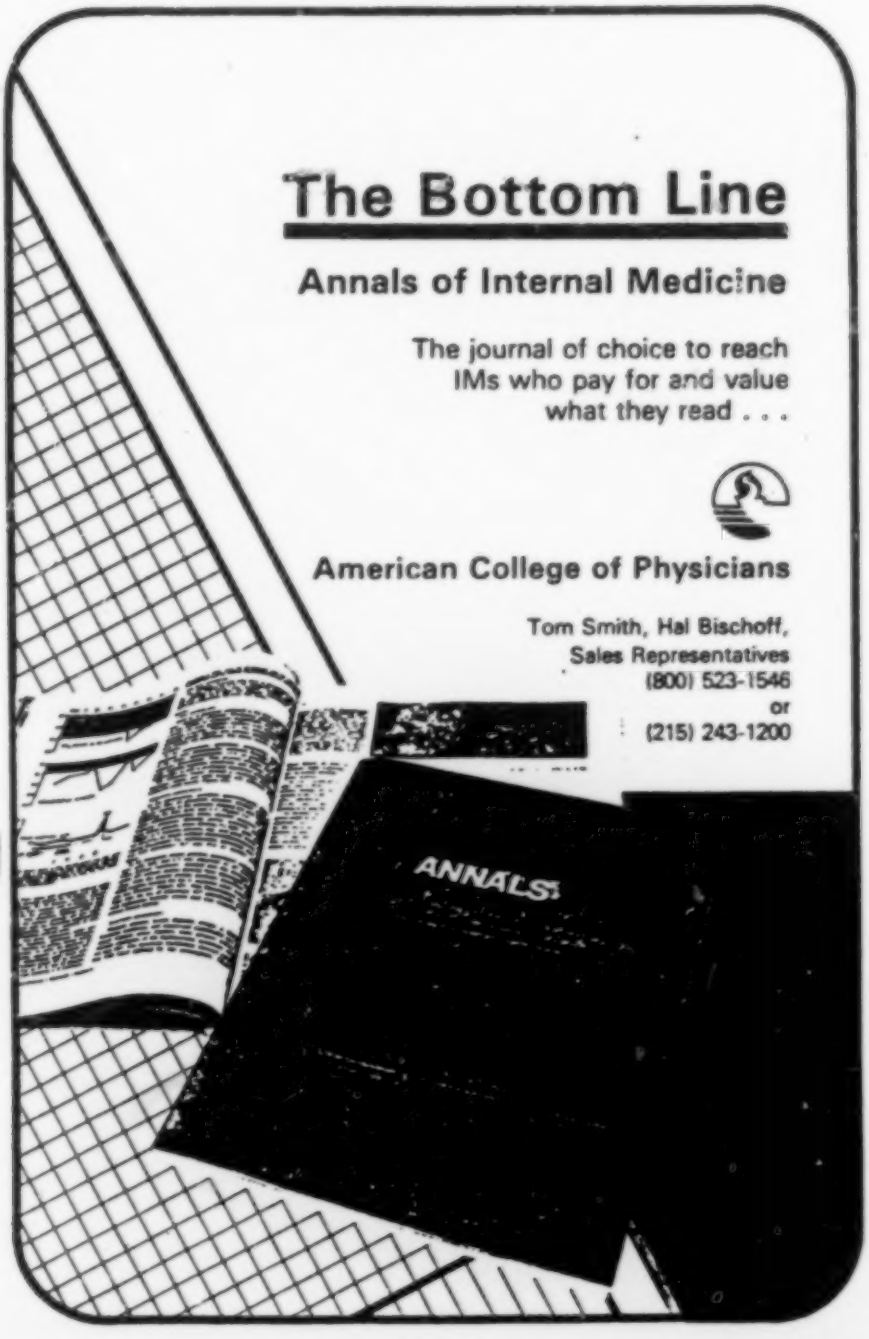
Sworn and subscribed before me this 29 day of October, 1984.
My commission expires
STATE OF NEW YORK
NEW YORK COUNTY

JOSEPH J. ZACCARIA, Notary Public
State of New York, 31-437550
Qualified in New York County
Commission Expires March 30, 1985

/s/ Joseph J. Zaccaria
Notary Public

APPENDIX A

Attachment No. 1



[Reproduced from *Medical Advertising News*, April 1984]

BEST AVAILABLE COPY

APPENDIX A

Attachment No. 2

You don't need a telescope to spot the newest star in the IM universe. It's ACP OBSERVER, teammate of the IM superstar, ANNALS OF INTERNAL MEDICINE.

In just one year ACP OBSERVER has added editorial pages and editorial color . . . has switched to better stock . . . has added several high-interest editorial features. And where once there were only a modest few "A"-size ads, now 4-color 2, 4 and 6-page spreads are showcased in every issue!

By including ACP OBSERVER on your schedule, you reach the entire membership of the American College of Physicians. Use this lively, interesting, and informative tabloid to reach the IM when he's relaxed and receptive . . . and eager to know the latest news from Washington, or the pros and cons of medicine's newest controversy.

Plan on scheduling ACP OBSERVER and ANNALS to cash in on the clout of the stellar Journal/Tabloid Team. You reach every ACP member twice a month, plus 46,000 non-members once a month when you use both. Add frequency discounts for the best buy in IM coverage.

For more information contact:

Tom Smith
Hal Bischoff
American College of Physicians
4200 Pine Street
Philadelphia, PA 19104
215 243-1200

ANNALS of Internal Medicine

OBSERVER

BEST AVAILABLE COPY

Supreme Court, U.S.
FILED
SEP 14 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1737 (a)

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

JOINT APPENDIX

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PETITION FOR WRIT OF CERTIORARI
Filed May 2, 1985
CERTIORARI GRANTED JULY 1, 1985

4 pp's
Folders

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*The opinion and judgment of the court of appeals, the order of the court of appeals denying rehearing en banc, and the opinion and judgment of the Claims Court, are printed in the appendix to the petition for writ of certiorari and have not been reproduced here.

UNITED STATES CLAIMS COURT

No. 415-82-T

THE AMERICAN COLLEGE OF PHYSICIANS

v.

THE UNITED STATES

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
Aug 17 1982	Filing fee of $10 paid by plaintiff.
Oct 14 1982	Notice of assignment to Chief Judge Alex Kozinski filed. Copy to parties.
Oct 15 1982	Defendant's motion for extension of time (to November 30, 1982) to file its answer, etc. filed. Service by mail: 10/15/82. ALLOWED; OCT 15, for 30 days only.
Oct 20 1982	Order of the Chief Judge governing proceedings before trial filed. Copy to parties.
Nov 15 1982	Defendant's motion for enlargement of time (to DEC 15 1982) to respond to the complaint filed. Service by mail: NOV 15 1982. ALLOWED; NOV 17 1982.
Dec 15 1982	Defendant's answer filed. Service by mail: DEC 15 1982.
Jan 17 1983	Notice to counsel filed. Copy to parties.
Jan 17 1983	Amended Order governing proceedings before trial filed. Copy to parties.
Feb 15 1983	Defendant's motion for enlargement of time (to APR 16 1983) to complete discovery filed. Service by mail: FEB 15 1983. ALLOWED FEB 16 1983. No further enlargements. See order of 1/17/83, Paragraph II(f).
Mar 24 1983	Plaintiff's motion for extension of time (to April 28, 1983) to answer defendant's interrogatories, Set. No. 1 filed. Service by mail: 3/23/83. DENIED. Counsel is directed to read the Court's Orders and comply with

	them strictly, etc.: MAR 28 1983. See endorsement on original motion.
Mar 30 1983	Defendant's opposition to plaintiff's motion for enlargement of time filed [by leave of the Judge]. Service by mail: 3/28/83.
Apr 12 1983	Defendant's motion for order compelling answers to interrogatories and response to request for production of documents filed. Service by mail: APR 12 1983. DENIED as Moot: MAY 6 1983.
Apr 25 1983	Order scheduling pretrial conference filed. Copy to parties.
May 5 1983	Defendant's motion for leave to withdraw or have denied as moot motion for order compelling answers to interrogatories and response to request for production filed. Service by mail: MAY 5 1983. ALLOWED: MAY 6 1983.
May 26 1983	Stipulation of facts filed.
May 26 1983	Pretrial list of exhibits of plaintiff filed. Service by mail: 5/26/83.
May 26 1983	Pretrial list of witnesses of plaintiff filed. Service by mail: 5/26/83.
May 26 1983	Pretrial memorandum of contentions of fact and law filed. Service by mail: 5/26/83.
May 26 1983	Defendant's submission in compliance with the amended order governing proceedings before trial filed. Service by mail: 5/26/83.
Jun 14 1983	Order of the Chief Judge allowing plaintiff to file pretrial brief (with response time according to normal schedule for dispositive motions under Rule 83.2), directing parties to file joint memorandum before the trial, and setting case for trial filed. Copy to parties.
Jun 21 1983	Transcript of proceedings (1 volume) taken at Washington, D.C. on June 2, 1983 filed. Notice to parties.
Jul 14 1983	Defendant's motion to vacate trial date, or to set briefing schedule [to order that no further briefs are to be filed after defendant's response to plaintiff's pretrial brief] filed. Service by mail: 7/14/83.
Jul 22 1983	Plaintiff's pretrial brief filed. Service by mail: 7/22/83.

Jul 29 1983	Plaintiff's response to defendant's motion to vacate trial date, or to set briefing schedule, filed. Service by mail: 7/28/83.
Aug 8 1983	Defendant's reply in support of its motion to vacate trial date, or to set briefing schedule filed. Service by mail: 8/8/83.
Aug 15 1983	Judge's order filed. [Defendant to file brief on AUG 22, 1983; Pltf's reply on SEPT 1, 1983; deft's reply on SEPT 12 1983; with hand delivery required.] Copy to parties.
Aug 22 1983	Defendant's trial brief filed. Service by mail: 8/22/83.
Aug 26 1983	Transcript of proceedings (1 volume) taken at Washington, D.C., on August 11, 1983 filed. Notice to parties.
Sep 1 1983	Plaintiff's reply brief filed. Service: 9/1/83.
Sep 8 1983	Defendant's motion for leave to substitute corrected copies of brief filed. Service by mail: SEP 8 1983. ALLOWED: SEP 12 1983.
Sep 12 1983	Corrected copy of defendant's trial brief filed. Service by mail: 8/22/83.
Sep 12 1983	Defendant's reply brief filed. Service by mail: 9/12/83.
Sep 14 1983	Plaintiff's statement of issues in dispute filed [by leave of the Judge].
Oct 3 1983	Transcript of proceedings (1 volume) taken at Washington, D.C. on September 14, 1983; together with plaintiff's exhibits 1 through 13; and defendant's exhibits 101 through 112 filed. Notice to parties.
Oct 21 1983	Opinion of the Chief Judge filed. Copies to parties.
Oct 24 1983	Judgement entered that the complaint is dismissed, with costs to the prevailing party. Copy to parties.
Dec 20 1983	Plaintiff's notice of appeal filed. Copy to defendant and CAFC. $70 filing fee paid.

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

No. 84-715

THE AMERICAN COLLEGE OF PHYSICIANS, APPELLANT

v.

THE UNITED STATES, APPELLEE

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS AND ORDERS
	COUNSEL FOR THE APPELLANT: John B. Huffaker COUNSEL FOR THE APPELLEE: Michael L. Paup, W.C. Rapp, Robert A. Bernstein COUNSEL FOR THE AMICUS CURIAE: Robert A. Saltzstein
December 30 1983	1. Certificate of Interest filed by appellant. (bam)
February 13 1984	2. Appellant's motion for transmission of trial exhibits to Court, filed. (ejc) *GRANTED:* February 15, 1984. (ejc)
February 15 1984	Received Plaintiff's Exhibits 1-12 and Defendant's Exhibits 101-112 from Claims Court. (exhibits in one box in storage) (ejc)
February 21 1984	BRIEF FOR APPELLANT/SEPARATE APPENDIX, filed. (SD-2/21-M) scg
April 2 1984	BRIEF FOR APPELLEE, filed. (SD-4/2-M) (ejc)
April 19 1984	REPLY BRIEF FOR APPELLANT, filed. (SD-4/18-M) scg
May 8 1984	THE PLAINTIFF'S EXHIBITS WERE USED IN ORAL ARGUMENT AND THE JUDGES ON THE PANEL KEPT THREE MAGAZINES FROM THE PLAINTIFF'S EXHIBITS. pjt

May 8 1984	ARGUED & SUBMITTED, before Baldwin, Smith & Nies, JJ.
Sept. 17 1984	Judgment reversed. Opinion by Smith, Circuit Judge. Separate opinion by Nies, Circuit Judge, concurring-in-part. pjt
October 1 1984	3. Appellee's motion for an extension of time (to and including October 31 1984) to file its petition for rehearing, filed. (SD-9/9/27-M) (ejc) *GRANTED:* OCTOBER 4, 1984.
October 31 1984	PETITION FOR REHEARING & SUGGESTION FOR REHEARING EN BANC FOR U.S., filed.
October 31 1984	4. Motion of American Business Press for leave to file a brief as amicus curiae in support of suggestion of United States for rehearing en banc, filed. (with affidavit in support) (SD-10/31-M) (ejc) *GRANTED:* November 2, 1984. (ejc) (per #25)
November 2 1984	BRIEF OF AMICUS CURIAE AMERICAN BUSINESS PRESS IN SUPPORT OF APPELLEE'S SUGGESTION FOR REHEARING EN BANC, filed. (SD-10/31-M) (ejc)
November 5 1984	5. Certificate of Interest filed by amicus curiae. (bam)
December 5 1984	Petition for rehearing denied and suggestion for rehearing in banc declined.
December 13 1984	MANDATE ISSUED TO THE CLAIMS COURT. (rs)
January 15 1985	Exhibits returned to the Claims Court by hand this date. (rs)
February 27 1985	6. Copy of letter to DOJ extending the time for filing petition for writ of certiorari to the Supreme Court to and including May 4, 1985, received. (ejc)
May 3 1985	PETITION FOR WRIT OF CERTIORARI IN U.S. SUPREME COURT (84-1737), FILED. (bam) *GRANTED:* 7/1/85.(bam)

IN THE UNITED STATES COURT OF CLAIMS

Docket No. 415-82 T

THE AMERICAN COLLEGE OF PHYSICIANS, PLAINTIFF,

v.

UNITED STATES OF AMERICA, DEFENDANT

PETITION

To the Honorable Chief Judge and Associate Judges of the United States Court of Claims.

1. Plaintiff herein, American College of Physicians, Inc., is a Delaware non-profit corporation located at 4200 Pine Street, Philadelphia, PA 19104.

2. Plaintiff brings this action to recover from the United States of America, Defendant herein, Federal income taxes in the amount of $55,965 erroneously and illegally collected for the calendar year 1975, or such other amount as the Court may determine to be lawfully due, together with interest thereon according to law.

3. This suit and the cause of action herein set forth arise under the Internal Revenue Code of 1954, as amended (26 U.S.C. §1 *et seq.*) (the "Code"), and the regulations promulgated thereunder. This suit is brought pursuant to, and within the period prescribed by, such Code and regulations for the recovery of Federal income taxes erroneously, illegally and wrongfully assessed and collected under the Code, together with interest thereon. This Court's jurisidiction is founded upon Title 28, United States Code, Section 1491.

4. Plaintiff is and always has been the sole and absolute owner of the claim herein presented. No transfer or assignment of such claim or any part thereof has ever been made. No action on this claim has been taken before the Congress of the United States or before any Department of the Government other than action before the Treasury Department as hereinafter described. No other suit or process by Plaintiff or any assignee is pending in any other court on this claim.

5. Plaintiff timely filed its income tax return (Form 990-T) for the calendar year 1975 with the District Director of Internal Revenue at Philadelphia, Pennsylvania. The amount of tax shown thereon was timely paid by Plaintiff.

6. The amount of income taxes erroneously and illegally collected from Plaintiff for the calendar year 1975 is $55,965. All of this amount, plus statutory interest thereon, is in controversy.

7. Plaintiff is and at all material times has been a tax-exempt organization described in Section 501(c)(3) of the Code. Plaintiff is and at all material times has been organized exclusively for charitable, educational and scientific purposes. Subject to the foregoing, the specific objects and purposes for which Plaintiff is and at all material times has been organized are to uphold and maintain high standards in medical education, medical practice and medical research; to encourage medical research especially in clinical medicine; to foster measures for the prevention of disease and for improving public health; to perpetuate the best traditions of medicine and to maintain high standards of medical ethics; and to maintain the dignity of the profession in its relationship with patients and the public.

8. During the year in issue, Plaintiff published two educational and scientific journals in furtherance of its exempt purposes: *Annals of Internal Medicine* and *The Bulletin*. Plaintiff carried advertisements in these journals almost exclusively for medical products and equipment of interest and assistance to plaintiff's members, all of whom are engaged in the practice of medicine or allied fields of education and research, and to others in the medical profession.

9. The collection of Federal income taxes at issue herein was based on the erroneous assumption that the net income from advertisements described in the preceding paragraph constituted unrelated business taxable income within the meaning of Section 512 of the Code as applicable to the year 1975. In fact, such receipts were from advertising which in and of itself was educational. The educational function of such advertising was not incidental; it was substantially related to the exercise or performance of Plaintiff's charitable, educational and scientific purposes. Accordingly, carrying

such advertising did not constitute an unrelated trade or business within the meaning of Section 513 of the Code, and the receipts from such advertising did not constitute unrelated business taxable income within the meaning of Section 512 of the Code. To the extent § 1.513-1(d)(4) of the Income Tax Regulations would require a different conclusion in this case, such regulations are invalid.

10. On or about June 12, 1979, Plaintiff filed with Defendant's representative a claim (Form 843) seeking refund on the grounds herein set forth of $55,965 of Federal income taxes assessed and collected with respect to the advertising income described in the preceding paragraphs. A true copy of said refund claim is attached hereto as Exhibit A.

11. Plaintiff's records contain no evidence of having received from Defendant a notice disallowing Plaintiff's claim for refund or of having signed a waiver of the requirement that such notice be sent (Form 2297). However, such notice would not have been sent, or such waiver would not have been signed, before August 19, 1980, the date on which Defendant secured Plaintiff's agreement to adjustments resulting from examination of Plaintiff's Form 990-T for 1975. Such adjustments in effect disallowed Plaintiff's claims for refund. (See the IRS examination report attached hereto as Exhibit B.)

12. By virtue of the facts set forth above, Defendant became legally indebted to Plaintiff in the amount of $55,965 for Federal income taxes erroneously, illegally and wrongfully assessed and collected for the year 1975, plus interest as provided by law from the date of payment thereof, and Plaintiff is justly entitled to such amount and interest from Defendant after allowing Defendant all just credits and setoffs.

WHEREFORE, Plaintiff prays for judgment against the United States of America, upon the facts and the law, in the amount of $55,965, or such other amount as may be legally payable in the premises, plus interest thereon as provided by law and for such other and futher relief to which Plaintiff may be entitled.

/s/ _____

JOHN B. HUFFAKER
2001 The Fidelity Building
123 South Broad Street
Philadelphia, PA 19109
(215) 893-3067
Counsel for Plaintiff

Of Counsel:
GORDON R. DOWNING
PEPPER, HAMILTON & SCHEETZ
2001 The Fidelity Building
123 South Broad Street
Philadelphia, PA 19109
(215) 893-3000

10a

Form **843**
(Rev. June 1972)
Department of the Treasury
Internal Revenue Service

Claim

If your claim is for an overpayment of income taxes, do NOT use this form (see Instructions)

Please print or type

Name of taxpayer or purchaser of stamps
THE AMERICAN COLLEGE OF PHYSICIANS

Number and street
4200 PINE STREET

City or town, State, and ZIP code
PHILADELPHIA, PA 19104

Fill in applicable items—Use attachments if necessary

1 Your social security number

2 Employer identification number
23-1520302

3 Internal Revenue Service office where return (if any) was filed
Philadelphia

4 Name and address shown on return, if different from above

5 Period—prepare separate form for each taxable period
From January 1, 19 75, to December 31, 1975.

6 Amount to be refunded or abated
$ 55,965

7 Dates of payment
June 14, 1976

8 Type of tax
☐ Employment ☐ Estate ☐ Excise ☐ Gift ☐ Stamp Income

9 Kind of return filed
☐ 706 ☐ 709 ☐ 720 ☐ 940 ☐ 941 ☐ 990-PF ☐ 4720 ☒ Other (specify) ▶ 990T

10 Explain why you believe this claim should be allowed and show computation of tax refund or abatement.

The advertising income received by this taxpayer does not constitute unrelated business income.

Under penalties of perjury, I declare that I have examined this claim, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Director's Stamp
(Date received)

Signed Fred C. Dierfeldt
Assistant Executive Vice Pres.

Dated 6/15/76, 19

For Internal Revenue Service Use Only

☐ Refund of taxes illegally, erroneously, or excessively collected.
☐ Refund of amount paid for stamps unused, or used in error or excess.
☐ Abatement of tax assessed (not applicable to estate or gift taxes).

See Instructions on back.

Form 843 (Rev. 6-72)

11A

EXHIBIT "A"

Internal Revenue Service
District Director

Department of the Treasury

Date:
SEP 1 0 1980

Kind of Tax: 990-T

Tax Year Ended: 12-31-75

51393_192_00094_6 23_1520302E 23438710
AMERICAN COLLEGE OF PHYSICIANS

8022
4200 PINE STREET
PHILADELPHIA, PA 19104 7512

Dear Taxpayer:

The enclosed report explains the adjustments agreed upon as a result of our examination of your tax return identified above. The paragraph checked below explains how settlement will be made.

☐ We will send you a bill for any additional tax plus interest if you have not already paid the full amount.
(If you send us a payment before you receive your bill, please write on it: "Audit Adjustment," your social security number, and the kind of tax and tax period for which it is intended. This will insure proper credit to your account.)

☐ We will send you a refund for the overpayment plus interest unless it is applied toward other taxes you owe.

☐ We will allow the overpayment as a credit against future liabilities.

☐ We will send you a notice of disallowance of your claim for credit or refund if you haven't signed a waiver of notification.

☐

Thank you for your cooperation.

RECEIVED
SEP 12 1980
J. H. CHAPPELLE
DIR., ADMIN, & FINANCE

Sincerely yours,

J. J. Ridenti

District Director

Enclosure:
Examination Report

600 Arch St., Philadelphia, PA 19106

Letter 891 (DO) (7-77)

EXHIBIT "B"

Report of Examination - Exempt Organizations

1. Form No.	2. Key District Office	3. Date of Report
990-T	PHILA, PA	

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation (If different from Item 4)
AMERICAN COLLEGE OF PHYSICIANS 4200 PINE STREET PHILA, PENNA 19104	

6. Social Security or Employer Identification No.	7. Tax Period	8. Private Foundation's Employer Identification No. (If different from Item 6)	9. Tax Period
23-1520302	12-31-75		

10. Report Preparer's Name	11. Agreement Secured (Check one)
JAMES E. COLL	☒ Yes ☐ No ☐ Partial
12. Findings Discussed With (Name)	**13. Agreement Date**
MR JOSEPH CHIAPPELLE, CONTROLLER	8-14-80

14a. Summary of Proposed Adjustments

Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (Private Foundations) (4)
511	12-31-75	55,965.-	
CLAIM	DISALLOWED	IN	FULL

14b. Penalty

Internal Revenue Code Section (1)	Amount (2)

Remarks: TAXPAYER FILED A CLAIM FOR REFUND IN THE ABOVE AMOUNT ON THE BASIS THAT ADVERTISING INCOME DOES NOT CONSTITUTE UNRELATED BUSINESS INCOME.

EXAMINATION CONFIRMS THAT ADVERTISING INCOME FROM THE "ANNALS OF MEDICINE" DOES CONSTITUTE UNRELATED BUSINESS INCOME UNDER SECTION 511 OF THE CODE. CLAIM DISALLOWED IN FULL

15. Schedules and Exhibits Attached

Form 4621 (Rev. 1-77) GPO 914-107 Department of the Treasury - Internal Revenue Service

EXHIBIT "B"

Page _____ of _____ page

Form 4549-A (Rev. September 1979) — Department of the Treasury – Internal Revenue

Income Tax Examination Changes

Return Form No. 990-T

Name and Address of Taxpayers	S.S. or E.I. Number	Filing Status
AMERICAN COLLEGE OF PHYSICIANS 4200 PINE ST. PHILA. PA. 19104	23-1526302	

Person With Whom Examination Changes Were Discussed — Name and Title: MR JOSEPH CHIARELLI, CONTROLLER

1. Adjustments to Income	Year: 1975	Year:	Year:
a.			
b.			
c.			
d.			
e.			
f.			
g.			
2. Total Adjustments	-0-		
3. Adjusted Gross, Taxable or Tax Table Income Shown on Return or as Previously Adjusted	94719.-		
4. Corrected Adjusted Gross, Taxable or Tax Table Income	94719 -		
5. Tax	55,965-		
6. Alternative Tax, If Applicable *(From Page _____)*	-		
7. Tax Surcharge	-		
8. Corrected Tax Liability *(Lesser of line 5 or 6, plus line 7)*	55,965-		
9. Less Credits *(specify)* a.			
b.			
c.	-		
10. Balance *(Line 8 less total of lines 9a through 9c)*	55,965-		
11. Plus: a. Tax from recomputing prior year investment credit	-		
b. Self-employment tax			
c.	-		
12. Total Corrected Income Tax Liability *(Line 10 plus total of lines 11a through 11c)*	55,965.-		
13. Total Tax Shown on Return or as Previously Adjusted	55,965.-		
14. Deficiency *(Increase in tax before credit adjustments, line 12 less line 13)*	-0-		
15. Overassessment *(Decrease in tax before credit adjustments, line 13 less line 12)*	-0-		
16. Adjustments to Prepayment Credits	-0-		
17. Balance Due *(Line 14 or 15 adjusted by line 16)*	-0-		
18. Overpayment *(Line 14 or 15 adjusted by line 16)*	-0-		
19. Penalties, if any *(See explanation)*	-0-		

Other Information

CLAIM DISALLOWED IN FULL

Examiner's Signature	District	Date
James E Cole	PHILA	8/ 1/80

Form 4549-A (Rev. 9-79)

EXHIBIT "B"

IN THE UNITED STATES CLAIMS COURT

No. 415-82 T

THE AMERICAN COLLEGE OF PHYSICIANS, PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

ANSWER

[Filed Dec. 15, 1982]

Defendant, the United States, in answer to the petition in the above-captioned case, respectfully denies each and every allegation contained therein not admitted, qualified, or expressly referred to below.

Defendant further:

1. Admits the allegations contained in paragraph 1.

2. Admits the allegations contained in paragraph 2, except denies that any amount has been erroneously or illegally collected from plaintiff.

3. Admits the allegations contained in the first sentence of paragraph 3. Avers that its attorneys are presently without knowledge or information sufficient to form a belief as to the truth of the allegations contained in the remainder of paragraph 3.

4-6. Avers that its attorneys are presently without knowlege or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 4 through 6.

7. Admits the allegations contained in the first sentence of paragraph 7. Avers that its attorneys are presently without knowledge or information sufficient to form a belief as to the truth of the allegations contained in the remainder of paragraph 7.

8. Avers that its attorneys are presently without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 8.

9. Avers that paragraph 9 is a legal argument, to which no response is required.

10-11. Avers that its attorneys are presently without knowlege or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 10 and 11.

12. Denies the allegations contained in paragraph 12.

WHEREFORE, defendant prays that the petition be dismissed, with all allowable costs assessed against plaintiff.

Respectfully submitted,

/s/ _____

GLENN L. ARCHER, JR.
Assistant Attorney General

W. C. RAPP
Attorney

IN THE UNITED STATES CLAIMS COURT

No. 415-82 T

AMERICAN COLLEGE OF PHYSICIANS, PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

STIPULATION OF FACTS[1]

[Filed May 26, 1983]

1. The College, founded in 1915, is exempt from federal income taxes under Section 501(a) and 501(c)(3) of the Internal Revenue Code.

2. For its taxable year 1975, the College timely paid federal income taxes in the amount of $55,965 with respect to income from advertising in its publications. On or about June 12, 1979, the College timely filed a claim for refund of these taxes. The College did not receive a notice of disallowance of this claim and did not waive receipt of such notice. The College timely filed a petition for a refund of these taxes on or about August 17, 1982.

3. The tax-exempt purposes of the College, as stated in the College's Articles of Incorporation, are, *inter alia*, (1) to uphold and to maintain high standards in medical education, medical practice [and medical research]; (2) to encourage research, especially in clinical medicine, and (3) to foster measures for the prevention of disease and for the improvement of public health.[2]

4. The College is a membership organization. Its members consist solely of members of the medical profession engaged in practice, teaching, research or other pursuits in the field of internal medicine or in allied or related specialities. In 1975, the College had approximately 32,000 members.

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[1] Unless otherwise indicated, the facts stipulated are applicable to 1975.

[2] The bracketed language was added after 1975.

5. In furtherance of its exempt purposes, the College publishes, *inter alia*, *Annals of Internal Medicine ("Annals")*. *Annals* contains scholarly articles relevant to the practice of internal medicine and is one of the most highly regarded medical journals in the field of internal medicine in the world.

6. *Annals* is provided to the College's members without additional charge as a benefit of membership. It is also available at a per issue price to, or may be subscribed for by, non-members. *Annals* also is circulated in medical schools and libraries (medical and non-medical) throughout the world. Its circulation in 1975 was roughly 73,000.

7. Each monthly issue of *Annals* contains advertisements relating only to medical products (primarily pharmaceuticals), supplies and equipment useful in the practice of internal medicine, and notices of positions available in connection with the practice of internal medicine. The advertisements for products, supplies, and equipment contain information about the use, indications and/or contraindications of and for such products, supplies, and equipment.

8. The College has a long-standing policy of accepting only those advertisements the content of which is restricted as described in the previous paragraph. To assure that the restrictions are met, every proffered advertisement is screened for accuracy and relevance to internal medicine. The College has rejected advertisements which have not conformed with its policy because of the type of products advertised or the inadequacy of information contained in the advertisements.

9. Advertisements in *Annals* are grouped or "stacked" in two sections, one in front of and one behind the editorial content of the publications.

10. In 1975, gross advertising income and direct advertising costs attributable to *Annals* were $1,376,322 and $833,050 respectively. Circulation income and readership costs attributable to Annals were $1,057,754 and $1,351,167 respectively. Another publication of the College produced an overall loss (excess of total periodical costs over total periodical income) of $96,471. The taxable income reported by the

College thus was $153,388 ($1,376,322 + $1,057,754 − $833,050 − $1,351,167 − $96,471).

11. No more than approximately 40 percent of the available page space in *Annals* is devoted to advertising on an average yearly basis.

12. Some medical journals are published by commercial organizations. Examples include American Journal of Cardiology (the official journal of the American College of Cardiology) and the American Journal of Medicine, which are (and were during 1975) published by a division of Dun and Bradstreet. Advertisements in the American Journal of Cardiology are grouped together in three "stacks," while those in the American Journal of Medicine are grouped together in a greater number of "stacks."

13. In some cases the advertisements appearing in plaintiff's publications are identical to advertisements appearing in medical journals published by non-exempt organizations, such as the two mentioned above.

14. In general, the College set advertising rates by reference to its costs and the need to be competitive with rates set by other similar medical journals.

15. The acceptance and publication of advertisements in the *Annals* during the year in suit constituted a trade or business, which was regularly carried on, within the meaning of Section 512 of the Internal Revenue Code of 1954, as in effect during the period in issue.

/s/ _____
JOHN B. HUFFAKER
Attorney for Plaintiff

/s/ _____
GLENN L. ARCHER, Jr.
Assistant Attorney General
Attorneys for Defendant

IN THE UNITED STATES CLAIMS COURT

No. 415-82T

THE AMERICAN COLLEGE OF PHYSICIANS, PLAINTIFF,

vs.

THE UNITED STATES, DEFENDANT.

EXCERPTS FROM TRANSCRIPT OF PROCEEDINGS, SEPTEMBER 14, 1983

---

[29] * * *

MR. HUFFAKER: Thank you, Your Honor.

We would like to call Dr. Robert Moser, who is our first witness.

Whereupon,

ROBERT MOSER, M.D.

having been first duly sworn, was called as a witness, examined and testified as follows:

DIRECT EXAMINATION

BY MR. HUFFAKER:

Q Would you state your full name and your present position, please?

A I'm Robert Harland Moser, and I'm the Executive Vice President of the American College of Physicians.

[30] Q Prior—when did you assume your present position?

A January 1st, 1977.

Q What was your medical experience prior to assuming that position?

A Well, I'm an internist-cardiologist. I received training in internal medicine, and had subsequent fellowships in pulmonary diseases, cardiovascular diseases and hematology. I spent 22 years in the Army as a medical officer; 15 of those years were as a teacher and as Chief of Medical Service at several Army hospitals.

I retired from the Army in 1969 as Chief of Medicine at Walter Reed.

I went into practice, private practice in a small town with a medical group. Did that, did internal medicine, general internal medicine, cardiology for about three years.

Then I went to the American Medical Association as the editor of the Journal of the American Medical Association and as the Director of the Division of Scientific Publications where I had responsibility for the 11 sub-specialty journals produced by the AMA.

I stayed there for about two and a half years. Returned to practice. And then was recruited for this present position in 1976, and have been there ever since.

Q The name of the Plaintiff is American College of Physicians.

[31] Would you tell us what you mean by a physician and what you distinguish that from internist? You refer to an internist.

A Well, at the time that the College was created in 1915, I assume that the distinction between a physician and an internist really had not been well defined.

We now realize and indicate that an internist is a physician who has had special training in the diagnosis and management of adult diseases exclusive of those related to surgery.

The original term "physician" was much more generic than that. But we are, if our proper name were given, we would be the American College of Internists. Although we do have some outstanding individuals from allied disciplines who are invited to become fellows of the College.

Does that answer your question?

Q Thank you.

Will you describe the program of the American College of Physicians as it was carried on in 1975 and as it's carried on today if it's any different?

A Well, the primary function of the College—I guess one of the primary functions of the College is medical education of internists and all others who wish to participate in our educational endeavors.

And through—by this—in this effort to [32] educate internists, the ultimate bottom-line hope is that this will provide better patient care throughout the efforts of these internists (sic).

We do this in a variety of ways. The College, in conjunction with the medical schools of the country, runs an average of 25 to 30 post-graduate courses a year that are dedicated to specific areas of internal medicine: cardiology, pharmacology, et cetera.

The College is divided into 72 regions. Each of these regions is obliged to have an annual meeting, and each of these annual meetings runs for one to two days, and scientific material is presented for the internists in that particular region. These are basically scientific programs.

We also put on a large annual session, once a year, runs for four days. It's an effort to expose our members to what is current in internal medicine. All of it is very intimately practice-related. It's a very large program, multiple simultaneous sessions.

We attract about 5,000 internists and others to this meeting. And it is our—the big show that we run annually. It's sort of the watershed of our year.

We also have a medical knowledge self-assessment program, which is now approaching its seventh edition. This is a program whereby all physicians, but most notably [33] internists, can take—study a syllabus that is related to the current information on the various sub-specialties of medicine that have been created in the preceding three years, it comes out every three years. Take questions, open-book type questions, send them in for computer scoring so they can compare their scores in the nine different areas of subspecialization to those of their peers who have also taken the examination.

And then they will receive critiques on the responses, the proper responses to the questions.

It's, in all candor, probably the best method that's been devised yet for physicians to assess their own current state of knowledge, and to take corrective action to shore up those areas where they seem to be somewhat deficient.

The success of the program is indicated by the fact that the College membership stands now at about 57,000, and we have—and the last two times we have sold well over 45,000 copies.

This is all voluntary. The internists, many of them, most of them are fellows and members of the College, but many come from outside.

And it's also extremely popular among medical students and house officers.

And then of course we have the Annals of Internal Medicine, which is sort of the flagship of our fleet. It is [34] the—again in all candor, I think the world's most prestigious publication in internal medicine.

It goes to some 87,000 members and subscribers. About, as I say, 57,000 members get it as a benefit of membership. And it goes to an additional 30,000 subscribers who have come from all disciplines, mostly internal medicine, and it's seen all over the world.

It is the most popular journal in internal medicine that is published in the world.

Aside from our educational endeavors, the College has always been involved in national standard setting. We work with other organizations through the Joint Commission on Accreditation of Hospitals to establish standards for hospital care, to insure that these standards are maintained in the hospitals.

We're also very much involved in standard setting for internal medicine training programs through participation in what's called the Resident's Review Committee where indeed we sit with the—two other organizations and evaluate the quality of training programs in internal medicine across the country.

So, in both of these areas, the College is also involved in a related educational endeavor but not quite the same as what I've described previously.

We are also very much involved in technology [35] assessment.

We are at the present time the only major national organization that is involved in the ongoing assessment of existing tests and procedures that are being used by practitioners in the field.

This program has been in existence for about seven years. It has matured significantly. And we are now about to launch a national network of internists who belong to the College who will provide input from the field about existing tests and procedures.

In addition, it is our intention that this network that is being utilized for the evaluation of tests and procedures, as soon as it is mature and functioning, will be used for post-

marketing drug surveillance. We hope to work with the FDA and with the PMA to do post-marketing drug surveillance in the field to—hopefully to expedite the knowledge gained about new drugs that are released for use by the profession.

The College is also involved in a major program of public education to advise the people, our patients and all other people about what they can do to help themselves to stay well and to keep themselves healthy.

This is done through a beginning, an embryo national network through our regions where physicians and internists who belong to the College will be called upon to [36] lecture community colleges, on local TV, et cetera. This is in its infancy, to be true; but it is a program that we hope will be national within about two years.

We also have a large health and public policy operation, which is very much involved in the issues of public welfare as they relate to our patients and to ourselves.

We are involved in addressing national issues, primarily as expert witnesses called upon by Congress and the regulatory agencies for expert testimony on areas related to cost containment, manpower, et cetera.

We're also involved in a program to try to assess some tech—to develop some technique to assess physician performance competence. By the survey of office and hospital records. This is a program of quality assurance that we're engaged in with two other national organizations.

We have two major councils of the college. One is called the Council of Sub-specialty Societies, wherein all of the major societies that are related to the subspecialties of internal medicine—meet in conjunction with the College twice a year. This includes the cardiologists, the gastroneurologists, all the other related sub-specialties. And we discuss issues of mutual concern to all organizations.

And our other council is called the Council of [37] Medical Specialties. And here we've embraced all of those that are allied to internal medicine, such as the geriatricians, the adolescentologists, and people who are in related disciplines but not necessarily those directly called sub-specialties of internal medicine.

This council addresses issues of how one can deal with the expanding problems in geriatric medicine, problems in ado-

lescent medicine, problems in environmental pollution, problems of adult immunization.

In other words, it has broadened the spectrum of College activity into areas that previously we had great difficulty addressing.

So, in summary, we have a broad range of interests, but the cardinal interest of the College remains the education of internists.

MR. HUFFAKER:—these are—this is the 1975 issues of the Annals. The witness has testified that this is a publication of the College.

I would like to have them marked and admitted in evidence.

Because of the broad stipulations in this case, Your Honor, I don't think we will be submitting any other exhibits for admission.

THE COURT: Response?

Have they been marked?

[38] MR. HUFFAKER: How would you—how would the Court like them marked?

THE COURT:—stamp.

MR. HUFFAKER: Stamp.

MR. RAPP: If I might inquire, Your Honor, are these going to be Exhibits 1 through 12, or—

MR. HUFFAKER: This will be—on the list of exhibits—

MR. RAPP: 27.

MR. HUFFAKER:—that was Exhibit 27. But this is because of the—the list of exhibits was arrived at before we entered into the very broad stipulations.

And so we really do not see that the other exhibits will be necessary.

So, would the Court—would it be a convenience to the Court to number these 1 through 12; or would you rather we retain the number in the submission and use A's, A, B, C's?

THE COURT: Probably be less confusing, since there are so few exhibits, to just number them 1 through 12—

You have one copy, I take it?

MR. HUFFAKER: Yes, Your Honor.

I believe we have previously submitted a copy to the Defendant.

MR. RAPP: We have possibly the only other complete [39] set from 1975, yes.

THE COURT: A collector's item.

MR. HUFFAKER: And we will ask permission to withdraw the exhibit at the conclusion of the case.

THE COURT: Oh, so, you're really not—oh, at the conclusion of the case.

Well, you may not want it stamped then. Perhaps what you ought to do then is affix a piece of paper with a staple or paper clip to each front cover, and put the exhibit stamp on that. That way you will have an unblemished set when—

Why don't you do this—why can't we do this at—

MR. HUFFAKER: We'll do that—

THE COURT:—over lunchtime. If you'd like me to look at those at this point, just hand them up and I'll look at them if the witness is going to testify about them. If not, just hold onto them until—we'll take them up when you have them marked.

MR. HUFFAKER: Thank you, Your Honor.

THE COURT: I have a stapler up here and I have paper clips up here as well.

And I think I have pieces of paper somewhere.

These yellow pads.

MR. HUFFAKER: We'll take care of the housekeeping at lunch, Your Honor.

[40] THE COURT: Very well.

BY MR. HUFFAKER:

Q Referring to the issues of the Annals, how would you describe the contents as to the subjects covered in it?

A You mean the scientific content?

Q Yes.

A Articles are selected on the basis of their pertinence to practicing internists.

They may be very clinical, that is related to direct bedside application, or they may be—represent new advances in the pathophysiology of disease, our knowledge of how disease occurs.

They may be related to new drugs that have been—have come on the scene and the early preliminary studies related to these drugs that may emerge as areas of interest to practicing internists.

There are—the Journal carries, I would say 95 percent of its material is directly related to the practice of internal medicine. There is a small section usually devoted to problems related to sociology, psychology, other aspects; but that represents a very small fraction of the material, the editorial material in the Journal.

Q The—how—does the Journal contain—does—advertising?

A Of course.

[41] Q How would you characterize the advertising?

A The advertising is basically from pharmaceutical companies that are—have usually recently had a new drug released by FDA and want to let the profession know very quickly that the drug is now available.

Sometimes a drug is released by FDA, an old drug with a new indication.

Also the pharmaceutical companies want this information to be made available to the physicians and they utilize the pages of the medical journals for this purpose.

We also run classified advertising for the benefit of our members, relating new positions that are available across the country, both in academia and also in private practice.

Q Have you had reason to evaluate the role of the advertisements in the Annals?

A Yes. If I may, I think I've summarized this in an editorial I was asked to write by the editor when I first came to the College back in '77.

And if it's okay, I think I can save a lot of time by just quoting from that particular editorial.

It's—I haven't changed my mind, and it's essentially what I still feel about the issue.

Q Well, I will submit the copy in evidence; but would you care to—

[42] A Just two sections that I'd like to read that I think are pertinent to what you just asked me.

This is, quote, "Drug advertisements in peer review journals are a vital part of continuing pharmacologic education. Since the Food and Drug Administration has imposed guidelines that limit advertising copy to content that does

not extend beyond package insert information, truth in advertising is not an issue.

"The eye-catching quality of the advertisement may determine whether the reader pauses at the page or passes it. Individual judgments will differ on an advertisement's format and taste, but the written content is guaranteed to be factual.

"The considerable literary and promotional talents of advertisements writers are brought to bear so that a busy clinician can catch the gist of the message in a flash.

"No one, including the advertisers, expects that any good clinician will leap up and dash off reams of prescriptions on the basis of an appealing advertisement. But it does serve an alerting function. To provoke the physician's interest to the extent that he will look further into the drug's use by reading a contemporary pharmacologic text, or ask his librarian to reproduce a few references from current journals, or look it up in the Medical Letter or the AMA drug evaluations.

[43] "This catching of the reader's attention is a short but important step on the trail of education on drug use to more enlightened prescribing habits."

And subsequently, "Most of us scan advertisements to see if some new product has surfaced that somehow has managed to escape our ritualistic perusal of favorite journals.

"Often we are surprised to find that a new product has come on the American scene. Perhaps it is one that has already thrived in Britain for a few years and has just recently emerged from the fine grinding mills of the FDA. Or it may be an entirely new drug that has been receiving rave notices in journals we do not read."

End of quote.

I still feel essentially the same, that the primary function that these advertisements serve to our members is to alert them, and to let them know about a new drug that has recently been released or an old drug that has been released for a new indication.

I don't think anyone has any pretense, as I indicated in the editorial, that this is the ultimate pharmacologic information that will make a determination as to whether a physician

prescribes that drug. But certainly it does serve a most valuable alerting function.

MR. HUFFAKER: May it please the Court, since [44] the doctor has read a portion of the editorial, I think it would be appropriate to admit the full into evidence. It was on the list of exhibits as P6. We would have it marked as Exhibit 13.

MR. RAPP: No objection, Your Honor.

THE COURT: Very well. You want to—do you have a copy for me and one for the Reporter, that will be even better.

Thank you.

And that's two sheets. And it's admitted—(The document referred to was marked for identification as Plaintiff's Exhibit No. 13 and admitted into evidence.)

BY MR. HUFFAKER:

Q Do all issues—all copies of the Annals contain advertising?

A No, they do not.

We have eliminated advertisements from all of the overseas issues that we produce.

This was done for two principal reasons. One is because in most foreign countries the drugs that are available in the United States may not be available, or they may be available and under different names and in different dosage, in different forms.

[45] Consequently, we thought it would not be very valuable to physicians abroad to have this information.

And second, a very practical matter, by reduction of the weight of the Journal by removing the advertisements, it made it a little cheaper for us to mail them overseas.

Q What has been the reaction of the foreign doctors to receiving this smaller edition?

A Well, it was curious that Dr. Huth, the editor, has received some informal—and some letters from foreign physicians in South America and Japan, to my knowledge, wondering why the drug advertisements had been removed from their copies of the Journal, expressing some interest in what is available in the United States, and not—and we were somewhat interested in that reaction.

We have no intention of putting them in, but there was considerable expression of their desire to have these advertisements so they could see what was being used in the United States.

MR. HUFFAKER: No further questions, Your Honor.

MR. RAPP: Good morning, Doctor.

THE WITNESS: Good morning.

MR. RAPP: I'm not going to keep you much longer.

CROSS-EXAMINATION

BY MR. RAPP:

Q In 1975, was insulin a new drug on the market in [46] the United States?

A No.

Q Darvon compound? Which I under—which is a brand name, I guess, but certainly you know what I'm talking about.

A Prepoxyphine (phonetic) was not a new drug. We—it had not—I don't recall actually when it hit the market, but it was—I think it had probably been out for four or five years.

Q Certainly niacine preparations were not newly being offered in 1975, were they?

A I don't know if they were being offered for any new indication. The use of vitamins does change now and then.

But I—it was certainly a well-known drug—vitamin.

Q Does the management of Annals make any attempt to make certain that the subjects, that is the drugs primarily, that are covered in each issue represent a comprehensive spectrum of the drugs that are available in the United States?

A I'm not sure I understand what you mean.

Q For instance, we pointed out before that Darvon is a brand-name drug. Other manufacturers then, whoever it is who owns the name "Darvon," manufacture the same [47] substance, don't they?

A I think at that time Darvon probably was still under its patent.

Q Well, certainly there are drugs that are pharmacologically identical but nevertheless are marketed by a number of drug manufacturers under different names.

A If a patent has expired, that is the case.

Q If an advertisement—if an advertiser seeks to advertise one of these competing drugs in Annals, Annals doesn't insist that all of its competitors advertise in the same issue, do they?

A Be a little difficult to do that.

Q I would certainly think so.

And certainly the Annals doesn't go out and seek advertising of certain classes of drugs because they think those will be of particular interest to the readers?

A No. I think that the—when a new drug that—is released that the industry certainly wants to get it propagandized to the profession, yes.

So, there's really very little need to go out and seek that.

Q And the Annals also publishes, in addition to advertisements for prescription drugs, there's advertisements for nonprescription drugs also.

A I think it does carry aspirin advertisements and [48] probably the acetaminophen, Tylenol.

Q Advertisements also for Maalox?

A Yes. I haven't checked the whole roster of drugs that are advertised—

Q Certainly.

A —most recently, but—

Q But you wouldn't be surprised to discover—

A No.

Q —a Maalox ad.

Support socks ads?

A No, I would not be surprised if some devices were advertised, yes.

Q Certainly. I wasn't surprised myself.

MR. RAPP: I have no further questions of this witness, Your Honor.

MR. HUFFAKER: No questions. Thank you, Doctor.

THE COURT: Thank you, Dr. Moser. You are excused.

(Witness excused.)

THE COURT: Mr. Huffaker?

MR. HUFFAKER: I'd like to call Dr. Edward Rosenow.

Whereupon,

EDWARD ROSENOW having been first duly sworn, was called as a witness, [49] examined and testified as follows:

MR. HUFFAKER: May I point out to the Court that the doctor is wearing a hearing aid, and we may have an occasional difficulty with a question, Your Honor.

THE COURT: I will certainly shout if necessary.

THE WITNESS: I can turn it down if you want.

DIRECT EXAMINATION

BY MR. HUFFAKER:

Q Your full name, please?

A Edward C. Rosenow, R-o-s-e-n-o-w, Junior.

Q Were you formally Executive Director of the College?

A I was the Executive Director from 1960 until I retired in 1977, with one change of title; I was made an Executive Vice President somehwere along the way.

Q Prior to becoming Director, Executive Director or Vice President of the College, what was your medical experience?

A Well, I grew up in Rochester, Minnesota. My father was a research bacteriologist at the Mayo Clinic. I went to Harvard Medical School and back to the Mayo Clinic for my training.

I've practiced internal medicine at Pasadena, California from 1940 until 1957. During that time I was also a Clinical Professor of Medicine at the University of [50] Southern California, a position in teaching that I continued when I came to Philadelphia at the University of Pennsylvania.

I edited a tape journal in California. And I was always interested in continuing medical education, and was for two and half years the Executive Director of the Los Angeles County Medical Association.

And I made the decision that I could probably effect better health care for more people if I gave up a one-to-one practice of medicine and became a medical society executive.

And that's why I moved to Philadelphia and became the Chief Administrative Officer of the American College of Physicians.

Q Could you describe the advertising policy, or the policy toward selection of advertisements in the Annals?

A At that time?

Q No sir. Start with when you came in, and—

A Well, this was an ongoing thing. I didn't start putting advertising in the Journal.

But this was in the years before—in the early 60's. It was before the FDA had made their rules about full disclosure and giving all the information in advertising.

So, we had to do that. We had a very active [51] committee of physicians in the Philadelphia area who would meet approximately once a month. And they would screen the advertising copy that would come to them. And make a decision about, number one, was it appropriate to the specialty of internal medicine and the allied health fields; and number two, was the content of the ad factual and accurate information.

And the third thing we did, which sometimes bothered the advertisers, we also took an opinion occasionally about what was an appropriate way of putting the information together. In other words, what was the makeup of the ad: was it attractive or was it revolting or—I found out a lot about advertising then, that apparently the more attractive it is apparently the less it sells anything. And so, we had some arguments about that.

But then we would—we'd pass this around to the doctors, and they would give other opinions, and they'd come to a decision. And then it was approved.

This took a lot of our time and effort.

And we also—part of the staff function, really, was to—we were authorized to turn down ads that had nothing whatever to do with internal medicine. Somebody might want to advertise a real estate development, or maybe might want to sell us some Crisscraft cars. We never put any of those kind of ads in.

[52] And occasionally we would—I remember when I appeared before the Ways and Means Committee, they asked me if we ever turned down an ad. And we did. Several times. And several times it resulted in a pharmaceutical company cancelling a two-year contract for monthly ads in the magazine.

The reason that we turned them down was that a statement would be made with which our committee could not agree.

One example: one company one time said, "Until you get the results of the test back, give penicillin." And our doctors didn't like that very well.

And we stuck by it, and it worked pretty well.

Q What—the screening of the ads must have used a great deal of time. Was this not only the paid staff of the College but also the membership, volunteer—

A That's right. Up once a month meetings.

Then we had a fairly small staff, but we had an advertising manager and a few people. And I spent a fair amount of my time looking over ads, talking on the telephone to people that felt that I needed to be put in the proper frame of mind about their ads.

I did my best to do this. But it was a much busier thing until after the FDA put in their requirements of full information.

[53] That kind of function pretty well dropped out, except that we still had a system worked out where one or the other of us—Dr. Kay was my assistant at that time, or I—would get guidance to the advertising manager whether a certain ad should be put in.

And occasionally we would get in touch with one of the experts at the university and check it down.

Q Have you had occasion to evaluate the importance of advertising to the readers of the Annals?

A Would you repeat that again?

Q Have you had occasion to evaluate the importance—

A Oh, yes.

Q —of advertising to the readers of the Annals?

A Yes. Before I made that trip to the Ways and Means Committee in '69, I did write around to a number of physicians known to me who were in the private practice for general internal medicine and I asked them what they felt the advantages and any possible disadvantages to putting advertising in the Journal.

And I got—from that group, I didn't survey all 30,000 of the members, but I got a very strong and positive reaction

that they found it a convenient way to be reminded of ads and to look at them. They found them very informational and educational.

I didn't have anybody say we shouldn't have them.

[54] Once in a while you'll get a professor in a medical school that thinks you shouldn't put anything in there except an article which one of his people has written.

But other than that, most doctors, I think, are favorable toward advertising.

They find it convenient to—I might say one thing to Your Honor. You may have heard the expression that the half-life of medical knowledge is about five or six years.

A good deal of the things that change very rapidly and all are the therapeutic modalities, the drugs and the various kinds of—and they change all the time.

And that's the part that goes away within five years. You have to learn something new.

So that anything—we always felt that anything we did to give the doctor reminders and things about therapeutic things was a very educational function we had to perform.

Q Did you have occasion to testify before the Ways and Means Committee in 1969?

A Yes, I did.

Q Could you relate to the Court the—what transpired at the hearing?

A Well, I was sort of a neophyte before the Ways and Means Committee. And so I found that after I'd read about [55] two paragraphs of my prepared statement, they weren't paying much attention to me.

In fact, they were busy doing some other things. And that bothered me a little bit. So, I shifted gears along in the middle of the thing and gave them a very extemporaneous bit of information about how I as a practicing physician would read Journal advertising.

And that—well, it's even in pretty poor English because when you talk it's not quite the same as when you write.

But in this I had—I wanted to get across to them that—and what I did, I had magazines like that. And at each place—and then I turned and went through the thing. In a fair number of ads and showed them what was being done

for high blood pressure. And everybody on the panel up there knows what high blood pressure is.

And that had a very good reception. And after I finished, one of the congressmen motioned for me to come up and talk to him.

And this was the end of a long day. You start about 10:00 in the morning and this was about 5:30 in the afternoon. I was the last witness. And we'd heard from all sorts of trade associations and some of these privately-held foundations where the father's the president, the mother's the vice president, the lawyer's the treasurer, [56] all these sort of things.

And he said, I've had no difficulty writing some kind of law that would exempt an organization like yours from taxation, but you can see it'd be a pretty hard job to write a bill that would fit you and all these other people.

Well, I said, that's your problem, it's not mine.

But, you know, it was an enjoyable experience. I didn't really feel that I'd convinced them too strongly. But I did urge them to not change the law to fit the regulations. I think that was the sort of sense of what I said at the time.

Q Did you testify concerning the relationship of the advertising to the exempt function?

A Yes, I did. I said that it was related.

Q Did you view your—the committee's action as consistent with your position, or—

MR. RAPP: Objection, Your Honor. This calls for a conclusion of the witness apparently about legal matters, what the actions of the Congressional committee were in response to his testimony.

I mean, I also don't see as a factual matter he can possibly know that.

MR. HUFFAKER: The wit—

THE COURT: I understand—a doctor and not an [57] attorney. Nevertheless, I would like to hear what he has to say on the subject.

So, permit him to testify.

Do you remember the question?

Would you like to repeat the question, Mr. Huffaker?

BY MR. HUFFAKER:

Q The—

A Well, I think I can simplify your question a little bit, because when I appeared before the Committee, they didn't have any action.

They were going to take some action. But at the time I have no knowledge of what action they might have taken or—so, I don't think that—the question I don't think I can quite answer either yes or no. Because I knew nothing about what their action was.

I knew what they were thinking of doing. And I knew what the Internal Revenue Service change in regulations on the old law from 1950 was. But I didn't know what they were going to do at that time.

Q All right.

MR. HUFFAKER: Thank you. No further questions.

MR. RAPP: The United States has no questions for this witness, Your Honor.

THE COURT:—

[58] THE WITNESS: Thank you very much

THE COURT: Thank you very much for your testimony. You are excused.

(Witness excused.)

MR. HUFFAKER: Dr. Lasagna, Louis Lasagna. Whereupon,

LOUIS LASAGNA, M.D. having been first duly sworn, was called as a witness, examined and testified as follows:

DIRECT EXAMINATION

BY MR. HUFFAKER:

Q Your full name and position, please.

A My name is Louis Lasagna. I'm Professor of Pharmacology and Medicine at the University of Rochester School of Medicine. Rochester, New York.

Q Could you relate your background as an academic and medical educator?

A Well, after house staff training in internal medicine, I spent two years at Johns Hopkins University School of Medicine in the Department of Pharmacology and Experimental Therapeutics. From there went to the Massachusetts General Hospital where I was a research associate in anaesthesia for two years.

Then I came back to Hopkins, and for 16 years organized and ran the Division of Clinical Pharmacology [59] in the medical school there.

In 1970, I went to the University of Rochester to become Chairman of the Department of Pharmacology and Toxicology as it was then called.

I stepped down from the chairmanship about three years ago.

Q As a specialist in drugs, do you have any responsibilities for finding out how the physicians keep up with the developments in the field?

A A part of our research over the years has been not only to study what drugs do but how they are used and what perceptions doctors have of them and what perceptions patients have of them and the problems that are involved in optimizing the use of medicinals in medicine.

Q How valuable or how lasting is the knowledge that the physician gets during his formal period of training?

A Well, if a physician were to retain only what he learned during his formal years of training, he'd be somewhat out of date on day one after that.

It would become increasingly out of date as the years went by. This is true not only of laboratory diagnostic tests and devices and what-have-you, but is very true about drugs, because the rate of new drug development is substantial, both new chemical entities that are marketed every year—there may be ten to thirty of those in the United States.

[60] But then there are also many more changes in old drugs, in dosage forms and strengths, what-have-you; new delivery systems.

And then there are changes that have already been alluded to, that is new information about old drugs that are already on the market, either new good things that those drugs do or new bad things that we've become aware of that those older drugs do.

Q You're familiar with the Annals of Internal Medicine?

A I am.

Q Have you formed an opinion concerning the relationship of the advertising in the Annals to the internist who would be the typical reader?

A Yes, I have.

Q Could you express that?

A I've been a subscriber to the Annals I suspect since about 1947, and I've had occasion not only to read it but to recommend it to medical students and young physicians and old physicians over a good period of years.

I consider it the premier journal for general internists.

And I think it's especially important that the scientific content, or the editorial content be looked at in a sort of point-counterpoint relationship with the [61] advertising in the Journal, because neither one alone would give a practicing physician a full basis of knowledge about using the drug.

For example, in the scientific pages of the Annals one may find a description of a new use of a drug, or a new adverse effect. That is not present in the official labeling of a drug. it is not present in the advertising.

So that the physician has to take that new piece of information—or it may be an opinion by an expert about a drug—and contrast it with what is the officially approved labeling. Because, while that labeling may be incomplete or out of date, it is nevertheless the official basis for promotion, and may have some implications if the physician strays beyond the labeling and gets into trouble.

So, I look on the various sections of the periodical as interacting in an important way in trying to keep doctors up to date.

Q Do you view the Annals as contributing importantly to keeping the doctors up to date?

A Oh, no doubt about it.

Q Those are high opinions of the Annals? Are you a member of the College?

A I'm not a member of the College.

Q Are you active in connection with other medical journals?

[62] A Yes, I am.

Q Are you familiar with the different methods by which journals are published?

Now, we would say this one is published by the College. Could you describe the way other journals are published?

A Well, there are some journals that are published by a private publishing house, where the motive, at least it's in part profit. Certainly education occurs through those journals as well.

Then there are also relationships between professional societies and private publishers wherein the society gets a return from the profits of that journal without taking any risk, and perhaps having less control over who edits it and how it's printed and where the ads are placed, et cetera.

So, you have the—a spectrum from a journal that is published really independently of any professional organization to one where the professional organization calls all the shots.

MR. HUFFAKER: No further questions, Your Honor.

MR. RAPP: Just one quick series, Doctor.

CROSS-EXAMINATION

BY MR. RAPP:

Q The American Journal of Medicine—I'm holding up [63] what's been marked for identification as Defendant's Exhibit 1—are you familiar with this?

A Yes sir.

Q Would this fall into the category that you've described as independent of the medical—the organized medical society or organization?

A Yes, it would.

Q And marked here for identification as Defendant's Exhibit 2, the American Journal of Cardiology. I would assume that this falls into the middle. This has—this is published as the official journal of the American College of Cardiology but is nevertheless not published by them.

That's one of the ones in the middle that you described?

A Yeah. I think that's correct, but I'm not—I'm not one hundred percent sure about that particular journal.

Q Are you familiar with the various ways that drug companies bring new drugs and new uses for old drugs to the attention of doctors?

A Yes, I am.

Q Could you describe for us all of the different ways that you're aware of that that's done?

A Well, there will be in addition to advertising in medical journals—there will be mail pieces—not all drug companies use that route, but some certainly do. [64] There will be visits to physicians by professional representatives of the company.

There will be meetings sponsored by pharmaceutical firms where physicians can attend.

I think those are the major ways.

MR. RAPP: Thank you very much, Doctor. I have no further questions of this witness.

MR. HUFFAKER: One question, Your Honor.

REDIRECT EXAMINATION

BY MR. HUFFAKER:

Q What is the function of the advertisement of a drug that has been on the market for some time?

MR. RAPP: Objection, Your Honor. He's asking a question that would require the doctor to form a conclusion as to the motive by whoever places the advertisement.

THE COURT: Perhaps we can inquire into Dr. Lasagna's basis, if any, for such knowledge.

BY MR. HUFFAKER:

Q Doctor, you are aware that some of the advertisements relate to drugs that have been on the market for some time?

A Yes, I am.

Q In your opinion, what service do these advertisements serve?

A As I've talked with people in the pharmaceutical [65] industry, I think they call those ads "reminder ads."

They keep the physician aware of the existence of the medication, which he has been aware of before, has used before. But the idea is to keep it still fresh in his mind.

Now, when an older drug is promoted because of new information, that is a new indication or a new adverse effect, the purpose is quite different. Then it's a matter of communicating brand new information about a drug that the physician has already perhaps used on many, many occasions.

MR. HUFFAKER: No further questions.

MR. RAPP: Nothing further, Your Honor.

THE COURT: That's all. Thank you.

(Witness excused.)

MR. HUFFAKER: Dr. Stewart Bondurant, please.

Whereupon,

STEWART BONDURANT, M.D. having been first duly sworn was called as a witness, examined and testified as follows:

DIRECT EXAMINATION

BY MR. HUFFAKER:

Q Will you state your full name and your present position?

A My name is Stewart Bondurant and I'm Dean of the [66] School of Medicine of the University of North Carolina at Chapel Hill.

Q Prior to assuming this position, could you give us your medical background?

A Well, I'm a graduate of Duke University School of Medicine, and the internship, residency and research fellowship at Duke University, and also was a resident at the Peter Brent Brigham Hospital of the Harvard medical complex.

I have been a full-time academician throughout my career, first on the faculty of the University of Indiana School of Medicine for ten years, and thereafter on the faculty of the Albany Medical College for 13 years, the first of that I was Chairman of the Department of Medicine with two responsibilities there that I think are relevant. One, is as director of the residency training program for internists. And the other is—was as physician-in-chief in the 800-bed Albany Medical Center Hospital.

I then became president and dean of the Albany Medical Center, in which position I served until 1979 when I assumed my present position.

Q Have you held offices in the American College of Physicians?

A I've held a number of offices in the American College of Physicians.

I served as Governor of the College for New York [67] during the late 1960's. And beginning in about 1970 I served on the Board of Regents of the College for five years. I was a member and Chairman of the Publications Committee, which is responsible for setting publications policies for the Annals.

I also served as Vice President and President of the College.

Q In the education of physicians, what is the focus of training with respect to responsibilities or future developments or sensitivity to future developments in the medical field?

A Well, as you've heard other speakers, other witnesses this morning describe, medicine like I guess many oth parts of society is much taken by this rapidity of change and the rapidity with which things become obsolete.

So that most medical schools—indeed, as far as I know, all medical schools in the country—have adopted the educational philosophy that their prime responsibility is to equip the student for a lifetime of learning.

So as to remain competent throughout life. Rather than the old-fashioned notion of imparting a fixed body of knowledge which can be the basis for professional practice.

In order to do that, most schools attempt with [68] varying success to communicate broad principles which are likely to be stable over time, and to create a framework for specific kinds of learning to the students, and also to teach the students how to continuously acquire new information and to acquire it critically, to judge critically as new treatments or diagnostic techniques or approaches are put forth so that they will exercise—be able to exercise a professional judgment as to what they retained.

There are many other themes in medical education. And I—but I think [that] is the key theme that's relevant this morning.

Q You're familiar with the Annals of Internal Medicine?

A Yes.

Q Can you—have you formed an opinion concerning the relationship of the advertising content of the Annals and the ongoing training of the physicians?

A Well, my opinion is very much the same as that summarized so well by Dr. Moser in his editorial that he wrote, and also by Dr. Lasagna immediately previously.

The material in the advertisements serves in a very effective way, in my judgment, as an alerting function. Students are—as Dr. Lasagna pointed out, students are encouraged to read the Annals. They do read it regularly. They are thereby exposed to this alerting function and learn [69] to incorporate it into their—as part of their learning—as part of their learning process.

Complementary, in a sense, to the scientific portion of the journal. Complementary in the sense of being not redundant.

Q I would assume that many of the ads that appear in the Annals would also appear in other medical journals.

A I believe—I'm sure—I know that to be the case.

Q Is there anything that is different—or, let's put it this way: Is it more important that an internist read the Annals than it is to read other medical publications?

A Well, there is a point which seems to me to be an important one, having been responsible for the education of internists, and that is that the internist, by virtue of being responsible for the care and treatment of diseases of the so-called internal organs or the organ systems of the—of man, not using surgical interventions of any kind, is, if not unique, very, very unusual among all specialities of physicians in the dependence on drugs.

The hall—to me it would be unthinkable that there could be a competent internist who is not a master clinical pharmacologist.

It is—at the very heart of internal medicine [70] is the sophisticated use and decision not to use drugs. The sophisticated decision of when to use and not to use drugs.

So that clinical pharmacology gets great emphasis in the residency programs by which we train internists, and pharmacologic—the mastery of drugs is really the hallmark in many—in a sense, the hallmark of the internist.

Q I would imagine that the practitioner has to budget his time, like all the rest of us. There are more things to do than he has time to do them.

Would you have views on a—whether the internist should have a regular program of reading?

A One of the things that we try to help our students to do is to develop patterns of learning which they can follow throughout their lives.

Different students develop different patterns. And we encourage each one to do his own.

But one of the patterns that is encouraged in many formal and informal ways is the use of journals as a—one of the keystones of a personal program of continuing education.

So that our students and our residents are encouraged in many ways to use the journals as an integral part of their professional continuing education.

[71] Q Would you view using the journals as including reviewing the advertisements?

A Yes.

MR. HUFFAKER: No further questions, Your Honor.

MR. RAPP: No questions for this witness, Your Honor.

THE COURT: Dr. Bondurant, thank you for your testimony. You're excused.

(Witness excused.)

MR. HUFFAKER: That concludes our case, Your Honor.

THE COURT: Maybe we could break for lunch at this point, and that will give you, Mr. Huffaker, opportunity to mark those exhibits, and also give you an opportunity to review Mr. Rapp's proposed exhibits to see whether you would have any objection or not.

After lunch we can take up defendant's exhibits.

MR. HUFFAKER: We'll have no objection to his exhibits.

THE COURT: Do you want to do it now, Mr. Rapp, then?

MR. RAPP: I would offer them again, Your Honor. I—they've already been marked and the reporter has a list describing them all.

THE COURT: Okay. This is what, Defendant's 101?

[72] MR. RAPP: Defendant's Exhibits 1 through 12.

THE COURT: You probably want—101 through 112.

MR. RAPP: We can certainly do that.

THE COURT: Why don't you do that?

I don't like to have duplication of numbers—

Very well, if there's no objection, why don't you introduce them?

Are these the same type of exhibits which—

MR. RAPP: Yes, Your Honor—

THE COURT: You only have one copy and you would like to have them—

MR. RAPP: Well, at the conclusion of the case, I had anticipated withdrawing them, yes.

THE COURT: Well, perhaps somebody—since I'm going to be going off to lunch anyway, maybe somebody can give me a copy of Annals to just look at.

MR. RAPP: Yes, might I encourage the Court to examine a copy of the Annals and copies of the Defendant's exhibits also?

THE COURT: Very well. Give me one of—whatever you want me to look at at lunch.

This will be, that what you just handed me is January 1975. Mr. Huffaker, you will reserve what, Exhibit 1 for that.

MR. HUFFAKER: That will be Exhibit 1, yes, Your [73] Honor.

THE COURT: Very well. And then I—

MR. RAPP: And these would be Exhibits—Defendant's Exhibits 101 and 102.

THE COURT: Very well. I'll—this will make interesting reading at lunch, although I will not rely on information in the advertisements because it's now been eight years and I'm sure they're all out of date.

Shall we meet at—what—what's a convenient time for all of you to come back from lunch?

MR. HUFFAKER: Just the convenience of the Court.

THE COURT: Would you prefer a shorter recess, a long recess?

You have clients here, Mr. Huffaker, or—what is—

MR. HUFFAKER: I have—

THE COURT: Are they going to be staying for argument—I don't really care. I'm just saying if they have to go out of town, they may prefer to be back—perhaps you can check with—

MR. HUFFAKER: Let me—may I conduct a—

THE COURT: Very well.

MR. HUFFAKER: —when we should come back?

I think 1:30 would be convenient from my point of view, Your Honor.

[74] THE COURT: That convenient for you?

MR. RAPP: 1:30, fine, yes.

THE COURT: 1:30 it is. See you—

THE CLERK: The Court is in recess.

(Whereupon, at 11:45 a.m., the hearing was recessed, to reconvene at 1:30 p.m., this same day, Wednesday, September 14, 1983.)

IN THE UNITED STATES CLAIMS COURT

No. 415-82T

THE AMERICAN COLLEGE OF PHYSICIANS, PLAINTIFF,

v.

THE UNITED STATES, DEFENDANT

EXCERPTS FROM TRANSCRIPT OF PROCEEDINGS, SEPTEMBER 14, 1983, SETTING FORTH ORAL FINDINGS OF THE CLAIMS COURT

[144] * * *

THE COURT: Please be seated.

* * *

I take it both cases now stand submitted, and there's nothing further anybody has thought of?

(No response.)

Very well.

Okay. Let's see what you got.

Now, first of all, to define the issues. And I think we understand what they are, but let's be sure that [145] we understand what the case is not about.

There is no question that has been raised about the purpose or the quality of the Annals journal.

There's no doubt from the testimony, and I think it's undisputed, that it is probably the world's foremost journal in the area of internal medicine.

There is also no question raised as to whether the activity that's carried on, the advertising activity, is consistent with the educational purposes of the journal. I think the Government has conceded and there is no disagreement that in fact putting in advertising is consistent, and the fact that monies being made on the advertising does not in any way detract or endanger the status of the organization as an exempt organization, at least certainly not in this litigation.

The question, and it's really rather a narrow question, is whether the income that is made by the College in selling advertising from—to be published in the journal is to be taxed.

And that turns on two issues: whether that activity is related or unrelated to the purposes of the organization, and if—and also whether it is being run by the conven—for the convenience of the members, whether the advertising is being run for the convenience of the members.

And as I think everybody agrees, the Government has [146] to prevail on both of those issues in order to prevail. Plaintiff can lose on one issue and succeed on the other and still—and still prevail.

Now, for me to pass—to divide—first of all, for the purposes of discussing the question of relatedness, it is convenient to divide the advertising of the two kinds, the kind that is called classified advertising and the kind is called unclassified advertising, or the nonclassified, or the drugs and drug manufacturers and so on.

Now, Plaintiff made an argument that the classified advertising does relate to the business of the organization. And I think the argument was made as well could be made, but I simply cannot accept that argument.

As far as the classified advertising is concerned, it deals with the individual concerns of members as professionals and not—is not nearly in an important way or a direct way related to the objectives of the College, which are to uphold and maintain high standards of medical educational practice, encouraging research, and fostering the prevention of disease.

Naturally, anything that helps physicians do their job more effectively, more efficiently, that gives them a better job opportunity will encourage the promotion of better health. I certainly would hope so.

But there are many other things that encourage the [147] promotion of better health. And as far as the classified advertising is concerned, I simply cannot find that they are—they meet the standard and that they are substantially related to the purpose of the College.

A closer question is presented on the question of the other advertising.

The question being whether the advertising activity serves the purposes of the organization.

And what has been proposed is that the advertising does that by educating the members who will read the editorial content and then will have an opportunity to also read the advertisements, and that would provide them information.

There's no doubt that advertising has educational value. All advertising has educational value.

But in this case there was really no showing that the advertising as a whole as published in the journal is related to the purposes of the organization, and that is to provide what we conceive to be a broad education of the members.

Advertising teaches certain things. There are things that the advertiser wants the reader to learn.

Advertising, by the way, by the way it is operated, is dependent upon the advertiser as to—a large extent as to the content, although the journal does exercise other [148] annals—journal does exercise some control.

But more importantly, it is really in the province of the advertiser as to whether or not the content of the advertising copy is a balanced showing of the—or a balanced presentation of what is available in the—in medicine.

One of the witnesses talked about the possibility of comparing advertising copy with the editorial content of the journal. But of course there's no assurance that if something is mentioned in the journal that—or particular products mentioned in the journal that will also be—appear in front or in the back in advertising. It depends a lot—great deal upon the budget of the organization that is producing the device or the drug whether it chooses to advertise, whether it likes to advertise in this particular journal, or—and such things.

Of course the journal could include lists of all available drugs and it could include advertising for its members free of charge if it chose to do so, if one could maximize availability of that kind of information; but of course it's not required to do so. It can consistent with its own purpose sell advertising as a business and sell it as a—and make a profit on it.

But when it does so, it begins to look a great deal like any other business.

[149] The comparison of the advertising in the Annals with that in other journals show that they are very similar, that from what I understand from the stipulation the rate cards of the rates charged are very similar, they're based on competition and not on some attempt to give—to use the advertising portion of the journal to give a balance or broad spectrum approach, or to give the readers a broad spectrum of information.

It is run a great [deal] like a business, and it raises to some extent the concerns of competitiveness with non-tax exempt organizations, which originally prompted the imposition of the unrelated business income tax.

This is not to say that advertising does not provide some assistance to the reader. It—advertising always does.

The question is whether it is—it meets the statutory tests and the regulatory tests. I think it is important that there is a regulation on point—and that is regulation Section 115, 1.512A—or rather F, 1.512F, which dealing specifically with the sale of advertising in a periodical by an exempt organization.

Now, Plaintiff has pointed out some inconsistency between this regulation and the example given further on. I don't think that the tension, if it exists at all, is terribly great.

[150] In any case, we have a regulation. And the language of the regulation is clear. And the Commissioner of Internal Revenue has a good deal of [discretion], as we all know, in drafting regulations.

And even if I were otherwise inclined, absent regulation 2, to give Plaintiff benefit of a doubt, I think the regulation—from me. And I find—hold that the—both the classified and the nonclassified advertising is not related—not substantially related to the business of the tax exempt organization.

The second major issue is whether or not it is—oh, incidentally, I am not today reaching the question that—the position proposed by the Government, and that is that relatedness deals with the conduct rather than the product of the organization. It does not necessarily mean that I will—that I'm persuaded by the point. I think it's a very seductive argument.

I simply don't know right here sitting in court today where the argument would lead.

And I've read the briefs and I've thought about it, but I'm not prepared—today. It does not mean that I wouldn't accept it in a case, or maybe if I should write something I wouldn't accept in this case.

Since I'm convinced that even looking at product the organization—does not meet the relatedness test. I [151] am avoiding what I think is in a sense the easier—the argument that's easier to explain but I think more difficult in its implications.

And so I'm basically not required to rule on the suggestion of the Government.

I think it's a seductive point. I think it's—it has certain appeal, and [a] certain satisfying consistency about it.

But maybe it's a little too consistent. I just have to think about it.

In any case, I am not addressing it today, and I'm basing my ruling on the degree of relatedness, and I simply find it's not enough.

The other issue is—I said is convenience of the members.

I'm sorry to say neither side gave me much help with this, and this is not I would blame either side. I think both counsel really did a very, very fine job of briefing and presenting what are—what are difficult issues, and helping the Court have [unintelligible].

But we have on the one hand the D and L test on the part of the Government, and on the part of Plaintiff the hand in glove test. This is made just for this.

I'm going to have to—I have—and I'm going to [152]—well, basically that's—it is on that basis I will decide it.

First I will find the language of the statute.

Somebody happen to know what page of this—of the brief—

MR. HUFFAKER: I can provide the Court with a copy of the Code which has the statute.

THE COURT: Please.

MR. HUFFAKER: —provide the Court with Code 513-2.

THE COURT: Thank you very much.

So, I had it open, and I closed it, and—I was looking for the convenience section.

MR. HUFFAKER: A2, Your Honor.

THE COURT: Ah.

That section provides that even if something is unrelated trade or business it should not be taxed if it's carried on in the case of this type of organization or case of a college or university—if it's carried by the organization primarily for the convenience of its members, students, patients, officers or employees.

And then it goes on to speak of other things.

It seems to me that the only way that that section can be read is by identifying the convenience of the individuals involved in their capacity as they are defined in the statute. That a dormitory is exempt, I presume because [153] Congress in the legislative history, but because it satisfies a need that is related to the student as a student, or order to—presume to get to classes in time and to have whatever concerns parents may have about sending away students to college, it may—it is part of going to college, or part of the ability of many students to go to college and may involve being on campus in the dormitory.

It certainly relates to that student's—or the students' activity as students. It facilitates their interaction with the exempt organization, and in many cases it may attract students—availability of on-campus housing attracts students that otherwise might not be there.

The test cannot apply to the convenience of people as people or in some other capacity.

This—the example was discussed about providing entertainment for students on campus. Unless it was somehow related to the function, the educational function of the campus, it seems to me would not—it would not be—the convenience test would not be met because entertainment is not part of the relationship between the student and the university.

And similarly—I mean it's for—certainly for the students' convenience but not for the convenience of the student.

I've racked my brain trying to figure out what it [54] is that the convenience for a member of the American College of Physicians—what membership involves and what the con-

venience for the member might involve for purposes of this section.

It cannot involve, obviously, convenience of the member as person. So, personal ads and the like, doctors are no different from other individuals, insofar as they are—certainly not by virtue of their membership in the American College are they any different with respect to their personal wants and needs.

Similarly, and that is a much closer point, the question of convenience cannot relate to their status as members of the profession.

The fact that they are members of the profession is a separate status from the member as—their members—their membership in the College.

And the many ads that might promote—advertisements that might promote their—that might be convenient to them as members of the profession, such as providing employment opportunities, such as providing teaching opportunities and the like, but would not necessarily make it easier for them to carry out their functions as members, whatever those functions may be at any one particular time, or that would be related to their status as members.

I have looked at one issue of Annals, and I have [155] frankly not looked at any of the others. You all have seen I've taken one with me.

I was not able to find any advertisement in here that related to the convenience of the members as members.

And I am willing to let counsel point to some in some of the other journals if they think that there are, but just to give examples of the things that I think are not, I'll add advertisements for drugs that certainly may assist members and may be convenient for members in—as professionals, but they really have no direct relationship on their status as members of the College. They don't in any way make it easier to perform the function of its members or attend membership functions or the like.

The—so, I thought all the glossy ads would not fall in that category. And although this was not an issue that was addressed as—certainly let Counsel point to some nonclassified ad—but might.

Nor was I able to see anything in the classified ads that related to anything other than the members' status as professionals.

And of course a professional status is very close to the status—or a person's status as a professional is very close to his status as a member of the professional organization related as a profession.

But there is a difference.

[156] And just as one can be a citizen and be a student and be a voter and be a member of the city council all at the same time, and all of those things are different, one can be many things, and only insofar as the physicians' functions as a member of organization are implicated would advertisements be for the convenience of the member under that section.

Therefore, I rule for the Defendant on that issue as well.

And I rule that—having ruled for Defendant on both issues, I find that the Plaintiff shall not prevail.

Are there any questions, any clarifications? I will before I go—if I need to, I will go through and answer the questions—Plaintiff, but before I do that, is there anything that counsel would like to ask or say or suggest at this point?

I'm willing to entertain.

I will file this, incidentally. This has been—this is Plaintiff's Statement of Issues in Dispute. And I will file it. But I will now refer to it in—I want to make sure that I've answered everything that's on here since—so, I've asked that the question be posed to me.

Question 1 is not capable of answering—being answered yes or no. This is an either/or question.

The answer to Question number 1 is unrelated [157] business income.

This is a legal issue number 1.

And the second question is: Can the income from advertising in a professional journal published by an organization described as a Section 501C3 of—be excluded from ordinary business income under the convenience of the members provision of Section 513A2?

And the answer is not in this case. I really would not want to rule in every case for all time.

Thank you.

This is now the taxable issues.

One, [does] the continuing updating of the knowledge of physicians concerning medical products and services available for patient care contribute importantly to the performance of Plaintiff's exempt functions.

Of course it does. And that's what—and that's what the editorial content of the—of the—of the Annals is about.

When it comes to advertising content, however, the answer to that is no.

Two, does Plaintiff's advertising contribute importantly to the continual updating of the knowledge? Well, that's a second question. The question (sic) to the first one is yes.

Two, does Plaintiff's advertising contribute [158] importantly to the continual updating of the knowledge of physicians concerning medical products and services available for patient care?

The answer is no.

And to question number 3 on page 3 is: the advertising Annals of Internal Medicine or impression thereof carried on primarily for the convenience of Plaintiff's members.

And with a footnote that I have not looked at every advertisement in every one of the journals presented into evidence, and on the basis of finding the first one, the one that I did look at, as being representative, the answer to that is no. It is not being carried on for the convenience of Plaintiff's members as members.

If there were some which met the standards of being carried on for the con—primarily for the convenience of Plaintiff's members as members, we'd have to decide the apportionment issue, or whether there were an apportionment.

And I simply don't—I will—consider that point.

I think that wraps up the case.

I'm really in a quandary as to whether I should write something on this or I should just rely on my—on my oral ruling and let it go at that. And I'm sure the [159] Appellate Court, if there should be an appeal, will be able to review the transcript.

Is there any preference on the part of either of the parties?

I may do what I plan to do anyway, but I would like to know what the parties think.

I—Mr. Huffaker?

MR. HUFFAKER: I think it fair to regard the issue that Your Honor has examined of the Annals as representative.

I don't see any reason to believe that if there were anything else that Your Honor hasn't found that it would be of sufficient size not to fall out under a de minimis rule.

So, first of all, I don't think that should hold things up.

Obviously, we can't make the judgement on appeal—

THE COURT: Oh, no, no. I certainly wouldn't want to—

MR. HUFFAKER: —[unintelligible].

THE COURT: Let me tell quite frankly, I—I guess like many others I'm backed up, and I don't think I could get an—I can get a judgement out very quickly. If I were to write on the subject, it would obviously take somewhat longer.

[160] I don't know what the party's situation is. I—those are the concerns. I may wind up doing what I'm going to do anyway after I check my workload, but I wanted to hear what the parties' preferences were given those two competing concerns.

MR. HUFFAKER: Well, we have, as I understand it, some rather novel issues on convenience where Your Honor has not much guidance from the statute—the regulations in arriving at conclusion.

And secondly, we have the question in the—of Your Honor's determination concerning the relatedness of the advertising, because it does contribute—it's how much, how important. And it really comes down to the Court determining that the expert witnesses didn't—weren't sufficiently persuasive.

I don't know frankly offhand whether that is a sufficient ground to support an appeal or not.

THE COURT: I really was not—I was not trying to corner you on that.

MR. HUFFAKER: Well, that's—

THE COURT: My feeling on appeal is we all need guidance from upstairs, and I was basically wondering whether, given—if I write something, it will take longer to get a piece

of paper from me. Would you have any preference? And I'm not sure whether you wouldn't—you'd be able to [161] make an appeal quicker if I just sent a judgment. If that's the way you—to do.

On the other hand, if I took the time to write something, it would be a while longer—in the writing. And it may make no difference to you at all. You may have preference. And that's all I was really asking.

You may have no preference. I don't mean to put you on the spot.

MR. HUFFAKER: I would think that it would be much more helpful if there is to be an appeal to have an opinion.

THE COURT: That's fine. I mean, that's—

Mr. Rapp?

MR. RAPP: I do have an opinion. And my opinion, Your Honor, is that—

THE COURT: Are you going to give it to me?

MR. RAPP: —to suggest—yes. Free of charge, my opinion is that the Court should write an opinion.

As we mentioned earlier, there are at least—

THE COURT: Oh, —had an opinion—

MR. RAPP: Ah. No. I—

THE COURT: Okay. No, I—

MR. RAPP: The—I—as we mentioned before, there are at least two cases pending in this court already with substantially similar issues involved. And this is a case of first impression in the federal court. So, this would be [162] the first decision on the subject.

For that reason, a written opinion would be of extreme value to the Government.

THE COURT: So, we have a definite yes and a mild yes that I ought to write something.

Okay. I really have to check my—what's going on upstairs—I do like to ask the parties. Once in a while I just rule, rely on the written transcript when things—but the views of parties are important.

So, chances are I will probably write something.

Once again, I want to commend Counsel, not only for what I think has been an excellent presentation of the facts and the law, but also for being what I thought was unusually co-

operative and both courteous to each other, and—and it's really been a great pleasure dealing with both of you individually, together, seeing you interact.

Thank you very much.

THE CLERK: Court is adjourned.

(Whereupon, at 4:45 p.m., the hearing was concluded.)

[Plaintiff's Exhibit P-13]

ANNALS OF INTERNAL MEDICINE

[July 1977]

ADVERTISING AND OUR JOURNAL

[114] The uncertain romance between scholarly journals and the drug industry has long been like a marriage of convenience between partners who become friends ultimately, not because they were fond of each other originally, but because they needed each other.

The fact is that without the financial support of drug houses the *Annals of Internal Medicine* would cost a full-rate subscriber about $37.00 per year instead of $25.00 (and members of the College an increase in dues to $92.00 per year). This fact also applies to all other peer-review journals in clinical medicine. This is what justifies the incorporation of drug advertising in this journal. We are pleased to have this support from advertisers. Without advertising income, the cost of this journal would be beyond the reach of many who need it most, especially students in their clinical years and house officers.

Much has been spoken and written about the impact of advertising on prescribing habits of American clinicians. I do not know how one can accurately assess its effects. The drug industry must believe that this advertising is effective; if it were not, their hard-nosed accountants would probably put an end to it.

Drug advertisements in peer-review journals are a vital part of continuing pharmacologic education. Since the Food and Drug Administration has imposed guidelines that limit advertising copy to content that does not extend beyond package-insert information, "truth in advertising" is not an issue. The eye-catching quality of the advertisement may determine whether the reader pauses at the page or passes it. Individual judgments will differ on an advertisement's for-

mat and taste, but the written content is guaranteed to be factual.

The considerable literary and promotional talents of advertisement writers are brought to bear so that a busy clinician can catch the gist of the message—in a flash. No one, including the advertisers, expects that any good clinician will leap up and dash off reams of prescriptions on the basis of an appealing advertisement. But it does serve an alerting function: to provoke the physician's interest to the extent that he will look further into the drug's use by reading a contemporary pharmacology text, or ask his librarian to reproduce a few recent references from current journals, or look it up in *The Medical Letter* or *AMA Drug Evaluations*. This catching of the reader's attention is a short but important step down the trail of education on drug use to more enlightening [*sic*] prescribing.

An old restless ghost needs to be put to rest. Do drug companies attempt to influence the publication policies of peer review journals? I ask you to conjure up the image of *anyone* trying to approach a Franz Ingelfinger or an Ed Huth or a Bob Moser on such a matter. It is "unconjurable"; it does not happen. Of course the drug houses, and [115] some other readers, may welcome some articles less than others, and they do not hesitate to express their dissent. They get their views into the rough and tumble exchange of "Letters to the Editor," furthering the enlightenment and entertainment of us all.

Some clinicians do not scan advertisements. Some purists would rather pay the $37.00 and have journals abandon drug advertisements; this constituency is so small that few medical journals could survive on this basis. But most of us scan advertisements to see if some new product has surfaced that somehow has managed to escape our ritualistic perusal of favorate journals. Often we are surprised to find that a new product has come to the American scene. Perhaps it is one that has already thrived in Britain for a few years and just recently has emerged from the fine-grinding mills of the FDA. Or it may be an entirely new drug that has been receiving rave notices in journals we do not read.

What about the "stacking" rather than "interspersing" of advertisements? As an old editor and older reader of medical journals, I have not been bothered by interspersing of advertisements, but in fact it does irritate most serious journal readers. It does tend to disrupt continuity of attention and thought. The set of mind in reading serious science should not be tampered with. Most of us scan the advertisements fore and aft, as a matter of course, usually before dipping into the well of original contributions. This is a part of the technique of reading a medical journal for most of us.

The "uncertain" romance has become less uncertain through the years, and the marriage of convenience has become more of a marriage of mutual regard and help. So we thank our old friends for their support, (*see* below) and we welcome any new friends in the drug industry to join the scholarly pages of *Annals of Internal Medicine.* (ROBERT H. MOSER, M.D., F.A.C.P.; *Executive Vice-President, American College of Physicians)*

Supreme Court of the United States

No. 84-1737

UNITED STATES, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

ORDER ALLOWING CERTIORARI.

[Filed July 1, 1985]

The petition herein for a writ of certiorari to the United States Court of Appeals for the Federal Circuit is granted.

Supreme Court, U.S.
FILED
SEP 14 1985
JOSEPH F. SPANIOL, JR.
CLERK

(8)

No. 84-1737

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether income derived by a tax-exempt medical association from the sale of commercial advertising space in its monthly journal is "unrelated business income" subject to tax under Sections 511 through 513 of the Internal Revenue Code.

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 743 F.2d 1570. The opinion of the Claims Court (Pet. App. 24a-33a) is reported at 3 Cl. Ct. 531.

JURISDICTION

The judgment of the court of appeals (Pet. App. 22a) was entered on September 17, 1984. A timely petition for rehearing was denied on December 5, 1984 (Pet. App. 23a). On February 26, 1985, the Chief Justice extended the time within which to petition for a writ of certiorari to and including May 4, 1985. The petition was filed on May 3, 1985, and was granted on July 1, 1985 (J.A. 62a). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 501, 511, 512, and 513 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Sections 1.512 and 1.513 of the Treasury Regulations on Income Tax (26 C.F.R.), are set out in a statutory appendix (Pet. App. 35a-54a).

STATEMENT

1. The basic facts were stipulated below (J.A. 16a-18a). The American College of Physicians is an association exempt from tax under Section 501(c)(3) of the Internal Revenue Code.[1] Its main purposes are to uphold high standards of medical education and practice and to encourage medical research (Pet. App. 24a-25a). Membership in the College is open only to those engaged in practice, teaching, research, or other professional activities in the field of internal medicine (*id.* at 2a). Respondent had approximately 32,000 members in 1975 (J.A. 16a).

In furtherance of its tax-exempt educational purposes, respondent publishes a monthly journal entitled *Annals of Internal Medicine.* The journal is provided to respondent's dues-paying members without charge and is sold to nonmembers on a per-issue basis or by subscription (Pet. App. 25a). Its circulation in 1975 was roughly 73,000 (*id.* at 3a). The journal contains scholarly articles relevant to the practice of internal medicine and is highly regarded in its field (*id.* at 2a).

Each issue of *Annals* also contains commercial advertisements. Up to 40% of the journal's available page space is devoted to advertising on an average yearly basis (J.A. 18a). It is respondent's policy to limit its advertising to those products and services that are useful in the practice of internal medicine (Pet. App. 3a). Some of the advertisements are classified ads, *e.g.*, notices of medical employment opportunities, or offers to buy, sell, or rent medical books, facilities, or equipment (Pet. App. 25a, 58a-59a; J.A. 48a; Br. in Opp. 3-4

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as in effect for the tax year at issue (the Code or I.R.C.).

& nn. 3 & 4). The bulk of respondent's ads relate to medical products, primarily drugs (Pet. App. 25a). Respondent screens all proffered advertisements as to subject matter and as to the accuracy of their content (*id.* at 3a).

Many of the advertisements appearing in *Annals* are identical with those appearing in medical journals published by taxable commercial publishers, such as the *American Journal of Medicine,* published by a division of Dun & Bradstreet (Pet. App. 28a; J.A. 18a, 43a).[2] Some of the advertisements are eye-catching, others strictly factual; some cover a fraction of a page, others several pages; some are in black and white, many in bright color (Pet. App. 28a). The advertisements are not dispersed throughout the journal, but rather are grouped in discrete "stacks" at the beginning and end of each issue. The same format is generally followed in medical journals published by taxable commercial publishers (*id.* at 3a; J.A. 18a). The advertisements are deleted when the *Annals* are permanently bound.

The advertisements appearing in *Annals* are prepared by the advertisers and not by respondent (Pet. App. 3a). Some of the ads are for established drugs and devices and are repeated from month to month (*id.* at 28a). No effort is made to coordinate the advertising with the journal's editorial content. Thus, it would be coincidental for a drug that is discussed in an article to be featured in an advertisement in the same issue (*id.* at 28a n.3). Advertising space is made available at rates competitive with those charged for advertising space in other medical journals, whether published by taxable or tax-exempt entities (*id.* at 3a; J.A. 18a). According to a

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[2] Selected advertisements appearing in *Annals* and in the *American Journal of Medicine* during January and February 1975 are reproduced at Pet. App. 55a-75a; Br. in Opp. App. B.

policy statement appearing in the July 1977 issue of *Annals*, what "justifies the incorporation of drug advertising in this journal" is the need to obtain "the financial support of drug houses" (J.A. 59a). Thus, it is an important source of revenue to respondent.

2. Sections 511 through 513 of the Code impose a tax on the "unrelated business income" of otherwise tax-exempt organizations like respondent. An "unrelated trade or business" is one the conduct of which "is not substantially related * * * to" (I.R.C. § 513(a)), *i.e.*, does not "contribute importantly to" (Treas. Reg. § 1.513-1(d)(2)), the accomplishment of the organization's tax-exempt purposes. Section 513(c), entitled "Advertising, Etc., Activities," provides that an activity (such as advertising) which bears the earmarks of an unrelated trade or business "does not lose identity as [such] merely because it is carried on within * * * a larger complex of other endeavors" (such as educational endeavors) that further an organization's tax-exempt goals. The Treasury Regulations generally provide that "amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business" (Treas. Reg. § 1.512(a)-1(f)).

Respondent's gross advertising revenue from *Annals* in 1975 was $1,376,322 (Pet. App. 3a). After taking into account allowable offsets and deductions, respondent reported "unrelated business taxable income" of $153,388 on its 1975 tax return (*id.* at 4a). Respondent timely filed that return and paid unrelated business income tax of $55,965 for that year (*ibid.*).

On June 12, 1979, respondent filed an administrative claim for refund of the tax thus paid (Pet. App. 4a; J.A. 8a, 10a). When the IRS demurred, respondent, on August 17, 1982, instituted this refund suit in the

Claims Court (Pet. App. 4a; J.A. 11a-12a). Respondent stipulated (J.A. 18a) that its solicitation and publication of commercial advertising was a "trade or business" and that this trade or business was "regularly carried on by it" (I.R.C. § 512(a)(1)). Respondent's principal contention was that its advertising business was "substantially related" to the performance of its educational purposes because "the advertising contains factual and technical data which * * * can help physicians keep up" with recent developments in medicine (Pet. App. 27a-28a).

Following a trial, the Claims Court (Kozinski, C.J.) entered judgment for the United States. The governing legal standards, the court held, were set forth in the Treasury Regulations, which "provide that advertising income of journals like *Annals* generally is taxable" (Pet. App. 29a, citing Treas. Reg. § 1.512(a)-1(f)). The court relied particularly on an Example set forth in the Regulations, an Example the court found "closely [to] resemble[ ] the situation here" (Pet. App. 29a, citing Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7)). That Example, involving a tax-exempt publisher of a professional journal, specifies that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute."

Evaluating the facts under these standards, the court found "unpersuasive" respondent's contention that the advertising in *Annals* "performs an educational function, supplementing the journal's editorial content" (Pet. App. 27a-28a). Respondent's advertising, the court found, "was typical commercial publicity" (*id.* at 28a). Many of the ads appearing in *Annals* were "identical to those appearing in medical journals published by non-exempt organizations," and the court found that any differences in format "plainly reflected the advertiser's

marketing strategy rather than their probable importance to the reader" (*id.* at 28a-29a). Some of the advertising, the court observed, was for well-known and established products like Valium, Insulin, and Maalox, a fact that "undermin[ed] the suggestion that the advertising was principally designed to alert readers of recent developments" (*id.* at 28a & n.4). The court found "[t]he evidence * * * clear that [respondent] did not use the advertising to provide its readers a comprehensive or systematic presentation of any aspect of the goods or services publicized" (*id.* at 28a (footnote omitted)). Rather, "the comprehensiveness and content of the advertising package [was] entirely dependent on each manufacturer's willingness to pay for space and the imagination of its advertising agency" (*id.* at 30a). The court found that respondent's advertising package served no "identifiable educational objective that goes substantially beyond the informational content" necessarily possessed by any advertising, and that any educational function the ads may have served "was incidental to [their] purpose of raising revenue" (*ibid.*). The Claims Court accordingly held that respondent's publication of commercial advertising was not an educational activity, that it did not "contribute importantly to the College's tax-exempt purposes," and that it was therefore subject to unrelated business income tax (*ibid.*).[3]

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[3] The Claims Court also rejected (Pet. App. 30a-33a) respondent's alternative contention that its product advertising was carried on "primarily for the convenience of its members" and was exempt from unrelated business income tax on that basis. See I.R.C. § 513(a)(2). The Federal Circuit upheld the Claims Court's findings in this respect (Pet. App. 19a) and respondent has not sought review of that holding here.

3. The Court of Appeals for the Federal Circuit reversed (Pet. App. 1a-21a). It concluded that the advertising in *Annals* contributes importantly to the accomplishment of respondent's educational purposes by "appris[ing] internists of developments in their field" (*id.* at 19a).

The court turned first to the legislative history accompanying Congress's enactment (in 1969) of Section 513(c), which, as noted above, is entitled "Advertising, Etc., Activities." While acknowledging language in the committee reports indicating that Congress "may have believed that advertising income should be taxed," the court dismissed this legislative history on the ground that it "addresses advertising generally and does not grapple with specific factual situations" (Pet. App. 12a-13a). As the court read the legislative history, Congress did not intend to "adopt a blanket rule" that commercial advertising revenues should be taxed, but rather left to the courts a case-by-case, ad-by-ad determination about whether or not particular advertisements are "substantially related" to an entity's educational objectives (*id.* at 17a-19a & n.23).

The court of appeals agreed with the Claims Court that the "primary purpose" of respondent's advertising was commercial and that its "educational function * * * may well have been secondary to the purpose of raising revenues" (Pet. App. 19a). The court held, however, that "[t]he commercial character of the activity is not * * * determinative" (*id.* at 16a). It concluded that the trial judge had "apparently [been] distracted by the commercial character of the advertisements" and had erroneously evaluated them under "a more rigorous standard than is supported by the statute" (*id.* at 16a, 18a). The court of appeals did not discuss, or even mention, the Treasury Regulation upon which the Claims

Court had based its decision. Rather, relying on testimony of respondent's expert witnesses that the trier of fact had found "unpersuasive" (*id.* at 16a-17a, 28a; J.A. 48a-49a), the court of appeals concluded that "the sales of advertising in *Annals* are substantially related to the exempt purpose of the College to educate internists" and that the Claims Court's conclusion to the contrary was "clearly erroneous" (*id.* at 19a).

The government's petition for rehearing, with suggestion of rehearing en banc, was denied (Pet. App. 23a).

SUMMARY OF ARGUMENT

1. The question in this case is whether respondent's commercial advertising profits are subject to unrelated business income tax. The answer depends on whether the publication of those ads is "substantially related to," that is, "contributes importantly to," the accomplishment of respondent's tax-exempt educational objectives. I.R.C. § 513(a); Treas. Reg. § 1.513-1(d)(2).

The relevant legal standard is set forth in Example 7 to Treas. Reg. § 1.513-1(d)(4)(iv), which was promulgated in 1967. Example 7 concludes that a tax-exempt professional association's publication, in its monthly journal, of advertising "designed and selected in the manner of ordinary commercial advertising is not an educational activity"; that publication of such advertising "does not contribute importantly to the accomplishment of [the organization's] exempt purposes"; and that the income from such advertisements "constitutes gross income from unrelated trade or business." The Regulation makes absolutely clear that "professional interest advertising," for products like drugs and medical devices, and "general consumer advertising," for products like soft drinks and cars, are to be treated identically in this respect. Compare Treas. Reg. § 1.513-1(d)(4)(iv) (Example 6) with *id.* (Example 7).

This Regulation was the subject of extensive hearings before Congress in 1969. The Regulation was attacked by spokesmen for the tax-exempt press, who argued that the Treasury lacked statutory authority to treat the publication of advertising as a "trade or business" distinct from the publication of a magazine generally. Those spokesmen further contended that professional interest advertising, in any event, was "substantially related" to the accomplishment of their educational goals and should be immune from tax on that basis. The Regulation was defended by spokesmen for the non-tax-exempt press, who viewed it as a necessary check upon the perceived inequity and anti-competitive effect of affording a tax subsidy to their competitors in the marketplace for advertising.

In the Tax Reform Act of 1969, Congress resolved the controversy by endorsing the Regulation, which it determined to "place[ ] in the tax laws" (S. Rep 91-552, 91st Cong., 1st Sess. 75 (1969)). Congress enacted Code Section 513(c), entitled "Advertising, Etc., Activities," which makes clear that the publication of advertising does constitute a discrete "trade or business" for purposes of the unrelated business income tax. And Congress concluded that, "by this standard, advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore * * * this income should be taxed" (H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 50 (1969)). Congress noted that the Regulation had "mainly affected the advertising income of publications such as medical journals" and stated that "[y]our committee wants to make clear that such regulations are valid" (*id.* at 44).

A long line of this Court's decisions confirms that interpretive rulings by the Treasury, "if found to 'implement the congressional mandate in some reasonable manner,'

must be upheld." *National Muffler Dealers Ass'n* v. *United States,* 440 U.S. 472, 476 (1979) (quoting *United States* v. *Cartwright,* 411 U.S. 546, 550 (1973)). And here the Regulation not only implements the congressional mandate, but was specifically endorsed by Congress when it enacted the mandate in question.

2. The court of appeals brushed aside this legislative history, asserting that it "addresses advertising generally and does not grapple with specific factual situations" (Pet. App. 13a). The court did not even mention the 1967 Regulation. Instead, it undertook its own subjective evaluation of respondent's advertisements, concluding that they were "educational" because they helped keep doctors professionally up-to-date.

The facts on which the court of appeals relied are irrelevant as a matter of law. Under the Regulation that Congress explicitly approved, the only relevant factual question is whether respondent's advertising is *commercial* publicity, that is, whether it is "designed and selected in the manner of ordinary commercial advertising" (Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7)). The Claims Court found as a fact that it was. The court determined that the advertising in *Annals* "was typical commercial publicity" and that respondent's advertising business "was operated in material respects like the advertising business of any other publication" (Pet. App. 28a, 33a). The court noted that many of respondent's ads "were identical to those appearing in medical journals published by non-exempt organizations" and that any differences in format or content reflected "the advertiser's marketing strategy rather than their probable importance to the reader" (*id.* at 28a-29a). Far from being exceptional, respondent's pharmaceutical product advertising is of the garden-variety commercial

type and is at the core of the problem that Congress and the Treasury took pains to resolve 16 years ago.

The court of appeals has invalidated sub silentio a Treasury Regulation that, having been explicitly endorsed by Congress, the court apparently did not dare invalidate in terms. In permitting respondent to operate its commercial advertising venture tax-free while its business rivals must pay tax, the decision below flouts Congress's design to achieve parity of tax treatment between exempt and non-exempt entities that publish advertisements for profit.

ARGUMENT

INCOME DERIVED BY A TAX-EXEMPT PROFESSIONAL ASSOCIATION FROM THE PUBLICATION OF ORDINARY COMMERCIAL ADVERTISING IS UNRELATED BUSINESS INCOME SUBJECT TO TAX UNDER SECTIONS 511 THROUGH 513 OF THE INTERNAL REVENUE CODE

A. The Treasury Regulations Set Forth A Per Se Rule That The Solicitation And Publication Of Advertising Designed And Selected In The Manner Of Ordinary Commercial Advertising Is Not An Educational Activity

1. The unrelated business income tax has its genesis in the Revenue Act of 1950, ch. 994, 64 Stat. 906 *et seq.* Before that law was enacted, charitable organizations that carried on ordinary trades or businesses were able to escape tax on their profits on the theory that the charitable "destination" of the revenues took precedence over their commercial "source." Thus, a nationwide vendor of macaroni (*C.F. Mueller Co.* v. *Commissioner,* 190 F.2d 120 (3d Cir. 1951)), and a commercial bathing beach facility (*Roche's Beach, Inc.* v. *Commissioner,* 96 F.2d 776 (2d Cir. 1938)), successfully claimed tax-exempt status simply because their business profits went to charity.

In the Revenue Act of 1950, Congress responded to this problem in two ways. First, it enacted the so-called "antifeeder" provision, now codified in Section 502(a) of the Code. Under that Section, organizations "operated for the primary purpose of carrying on a trade or business for profit" cannot claim tax exemption solely on the ground that their profits go to charity. Second, Congress enacted the "unrelated business income tax," now codified in Sections 511 through 513. Section 511(a) imposes a tax, generally at regular corporate rates, "on the unrelated business taxable income" of most tax-exempt groups. Section 512(a) defines an organization's "unrelated business taxable income" as income derived "from any unrelated trade or business * * * regularly carried on by it." Section 513(a) in turn defines an "unrelated trade or business" as "any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption."

The chief impetus behind the new tax was Congress's desire to put the business operations of tax-exempt organizations on an equal footing with those of their taxable commercial counterparts. The House Report stated that "[t]he problem at which the tax on unrelated business income is directed * * * is primarily that of unfair competition." H.R. Rep. 2319, 81st Cong., 2d Sess. 36 (1950). The tax falls on business revenues, not on membership dues or investment income, since Congress regarded the latter sources of funds as traditional and proper mainstays for charitable institutions. S. Rep. 2375, 81st Cong., 2d Sess. 30-31 (1950). As amended by Congress in 1950, the Code "does not deny [a tax]

exemption where the organizations are carrying on unrelated active business enterprises, or require that they dispose of such businesses, but merely imposes the same tax on income derived therefrom as is borne by their competitors" (H.R. Rep. 2319, *supra*, at 37).

2. During the years following the enactment of the unrelated business income tax, uncertainty arose as to whether the tax extended to profits derived by tax-exempt organizations from the solicitation and sale of commercial advertising space in their publications. The IRS took preliminary steps toward taxing journal advertising profits in 1955. See Lehrfeld, *The Unfairness Doctrine: Commercial Advertising Profits as Unrelated Business Income*, 23 Tax Law. 349, 351-352 (1970); Webster, *Unrelated Business Income*, 23 Tax Law. 471, 476 (1970). These steps were temporarily suspended two years later, when the Commissioner "ordered a thorough legal and economic study of advertising income." Lehrfeld, *supra*, 23 Tax Law. at 352.

As contemporary commentators noted, there were two technical arguments against applying the unrelated business income tax to journal advertising profits under the law as it stood in 1950. First, it was universally acknowledged that a journal's articles and editorial content furthered the sponsoring organization's tax-exempt goals. Since the commercial advertisments arguably were part and parcel of a unified trade or business ("publishing") with an ultimately educational end, the tax was said to be inapplicable. See, *e.g.*, Weithorn & Liles, *Unrelated Business Income Tax: Changes Affecting Journal Advertising Revenues*, 45 Taxes 791, 798-800 (1967); Webster, *New Proposals Change Definition of Unrelated Business Income*, 23 J. Tax. 42, 43 (1967); Middleditch & Webster, *The New Unrelated Business Income Regs: What They Mean*,

How to Cope With Them, 24 J. Tax. 174, 176 (1968); Moore, *Current Problems of Exempt Organizations*, 24 Tax. L. Rev. 469, 472 (1969).

A second argument was pressed by tax-exempt publishers of trade and professional journals that eschewed general consumer advertising (*e.g.*, ads for margarine or cars) and restricted their advertising to products and services within the area of their members' professional interest. It was said that such advertising itself promoted, *i.e.*, was "related to," the sponsoring organization's educational objectives by helping members stay up-to-date professionally. See, *e.g.*, Webster, *Effect of Business Activities on Exempt Organizations*, 43 Taxes 777, 788 (1965); Middleditch & Webster, *supra*, 24 J. Tax at 175; Comment, *Taxation: Unrelated Business Income Tax (Sections 511-513) and the 1967 Regulations*, 33 Mo. L. Rev. 230, 246 (1968); Weithorn & Liles, *supra*, 45 Taxes at 806-807. Trade and professional journals, of course, held considerable appeal for advertisers of specialized products, who recognized that such publications had "as [their] primary audience a potential market for [such] product[s] greater than some other, random, heterogeneous advertising audience." Lehrfeld, *supra*, 23 Tax Law. at 357. Indeed, "the vast majority" of tax-exempt journals that published advertising at the time were "special-interest business, trade and technical journals." Wall St. J., July 24, 1964, at 1, col. 6. This second argument was thus available to most tax-exempt groups that published advertising for profit.

3. In June 1964, Commissioner Mortimer M. Caplin confirmed that the Treasury, after prolonged study, was drafting regulations concerning "the extent to which an organization, otherwise exempt, is subject to tax on its income from advertising in periodicals and other publications." Weithorn & Liles, *supra*, 45 Taxes

at 791. Rumors to that effect had earlier made the rounds of the tax-exempt press. See, *e.g.*, Rogovin, *Tax Exemption: Current Thinking Within the Service*, 22 N.Y.U. Inst. Fed. Tax. 945, 961 & n.29 (1964); Webster, *supra*, 43 Taxes at 786-787; Weithorn & Liles, *supra*, 45 Taxes at 791. The anticipated Regulation was issued in proposed form in April 1967. Prop. Reg. § 1.513-1, 32 Fed. Reg. 5993. It was accompanied by a Technical Information Release explaining that it was designed "to make it clear that the unrelated business income tax applies to profits which exempt organizations derive from the sale of advertising in periodicals which they publish." TIR-899 (Apr. 14, 1967), *reprinted in* 1967 Fed. Taxes (P-H) ¶ 54,862.

The Proposed Regulation addressed, and rejected, both of the technical arguments outlined above against taxation of professional journal advertising profits. The Treasury announced its intention to "fragment" tax-exempt publications into two components—commercial advertising, the income from which would be subject to unrelated business income tax, and articles and editorial content, the income from which (typically, subscription or dues income) would remain tax-free. Articulating the "fragmentation" concept, the Proposed Regulation set forth the general rule that income-producing activities "do not lose identity as [a] trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization." Prop. Reg. § 1.513-1(b), 32 Fed. Reg. 5993 (1967). "Thus," the Treasury explained, "activities of soliciting, selling, and publishing commercial advertising do not lose identity as [a] trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to [its] exempt purposes" (*ibid.*).

To illustrate this principle, the Proposed Regulation set forth an Example involving a tax-exempt trade group ("Z") that publishes a monthly journal containing articles and commercial advertising. Prop. Reg. § 1.513-1(d)(4)(iv)(Example 6), 32 Fed. Reg. 5995 (1967). The Example concluded that the journal's editorial content "contribute[s] importantly to the accomplishment" of the organization's tax-exempt purposes, and hence that its subscription income "does not constitute gross income from unrelated trade or business" (*ibid.*). On the other hand, the Example held that "[n]either the publication of advertisments nor the performance of services for commercial advertisers contributes importantly to the accomplishment of any purpose for which exemption is granted," so that the journal's advertising profits were subject to tax.

4. The Proposed Regulation provoked written comments from some 400 organizations, many of which testified at hearings held by the Treasury in July 1967. Taxpaying publishers praised the proposal as a means of restricting the competitive edge enjoyed by their tax-exempt counterparts. The tax-exempt press, on the other hand, attacked the Proposed Regulation as contrary to congressional intent and to prior IRS practice. Many faulted the Treasury's proposal, not only for adopting the "fragmentation" concept, but also for creating, with insufficient explanation, "a *per se* rule as to advertising from commercial sources." Lehrfeld, *supra*, 23 Tax Law. at 350.

In response to the comments received, the Treasury revised Example 6 of the Proposed Regulation, and inserted a new Example 7, to elaborate and clarify the basis for its conclusion that *all* commercial advertising profits are subject to unrelated business income tax. As thus revised, the Regulation carried forward the substance of the Treasury's original proposal. The

Regulation was published in final form in December 1967 (Treas. Reg. § 1.513-1, 32 Fed. Reg. 17657). It has remained essentially unchanged ever since.

Examples 6 and 7 of the Final Regulation each involve a trade association (again named "Z") formed "to advance the interests of a particular profession and drawing its membership from the members of that profession" (32 Fed. Reg. 17659 (1967)). The association publishes a monthly journal that carries articles and commercial advertising. In Example 6, Z publishes "general consumer advertising" for products like "soft drinks, automobiles, articles of apparel, and home appliances." The Example concludes that such advertising revenues represent "gross income from [an] unrelated trade or business" (*ibid.*). In Example 7, the facts are the same as in Example 6, "except that the advertising in Z's journal promotes only products which are within the general area of professional interest of its members." Example 7 elaborates the hypothetical facts as follows:

> Following a practice common among taxable magazines which publish advertising, Z requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, Z accepts advertising only from those who are willing to pay its prescribed rates.

The Example acknowledges that "continuing education of its members in matters pertaining to their profession is one of the purposes for which Z is granted exemption." It concludes, however, that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute" (32 Fed. Reg. 17659 (1967)). Thus, "Z's publication of advertising does not contribute importantly to the accomplishment of its exempt purposes; and the income which it derives from advertising constitutes gross income from unrelated trade or business" (*ibid.*).

B. In Amending The Tax Laws In 1969, Congress Explicitly Approved The Regulation In Question And Announced That, Under The Statutory Standard It Was Then Adopting, All Commercial Advertising Profits Of Tax-Exempt Professional Journals Are Subject To Unrelated Business Income Tax

1. The Final Regulation triggered a renewed storm of protest from tax-exempt publishers. Estimates before Congress indicated that the Regulation would affect "[s]ome 700 fraternal, educational, cultural, scientific, professional, trade, and labor organizations" with gross advertising revenues of about $100 million. See 114 Cong. Rec. 7879 (1968). During 1968, members of the House sympathetic to their interests introduced numerous bills to block the Regulation's implementation. See Lehrfeld, *supra*, 23 Tax Law. at 364-365; Weithorn & Liles, *supra*, 45 Taxes at 792 n.8. These initiatives were unsuccessful.

Several attempts along similar lines were made in the Senate. In March 1968, the Senate approved a measure, initiated on the floor, that would have amended Section 513(a) of the Code to specify that the publication of commercial advertising in an exempt-organization periodical is not an unrelated trade or business. 114 Cong. Rec. 7879-7881 (1968). The amendment was deleted in conference, on the understanding that the House Ways

and Means Committee would consider the subject later that year. See S. Rep. 1497, 90th Cong., 2d Sess. 11 (1968). In September 1968, the Senate Finance Committee reported out an amendment to a water conservation bill that would have postponed for one year the Regulation's effective date. See 114 Cong. Rec. 27617, 27619 (1968). According to the accompanying Report, the Committee thought such a deferral appropriate "[i]n view of the substantial impact of the new regulations and the widespread concern which has been expressed regarding them" (S. Rep. 1497, *supra*, at 11). The proposal to defer the Regulation's effective date was defeated on the floor. 114 Cong. Rec. 27785-27788 (1968). Senator Anderson, who led the opposition to the proposal, observed that it would "open[ ] up a loophole that could cost the general taxpayers $25,000,000 a year" (*id.* at 27785). Senator Metcalf agreed, stating that "it is difficult to see why th[e] tax exemption should be spread beyond its necessary limits to give a tax-exempt organization an unwarranted and unnecessary competitive advantage over its taxable business competitors" (*id.* at 27787).

2. The promised hearings were held the following year, and the Regulation was subjected to several days of scrutiny by spokesmen for both the tax-exempt and the non-exempt press. See *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. (1969) [hereinafter cited as *House Hearings*]; *Tax Reform Act of 1969: Hearings on H.R. 13270 Before the Senate Comm. on Finance*, 91st Cong., 1st Sess. (1969) [hereinafter cited as *Senate Hearings*]. Publishers of medical journals were well represented. See, *e.g.*, *House Hearings* 1259 (American Medical Ass'n); *id.* at 1211 (American Dental Ass'n); *id.* at 1117 (American Psychiatric Ass'n); *id.* at 1110 (American College of Physicians, respondent here); *id.* at 1150

(Reuben H. Donnelley Corp.); *id.* at 1205 (C.V. Mosby Co.). Witnesses on both sides iterated before Congress the arguments they had previously advanced to the Treasury.

Tax-exempt publishers opposed the Regulation on two principal grounds. First, they contended that the Treasury lacked statutory authority to "fragment" publishing activity and to treat commercial advertising as a "trade or business" distinct from the publication of a journal generally. See, *e.g.*, *House Hearings* 1111, 1128-1129, 1184, 1213, 1223. That contention, if accepted, would have shielded virtually all advertising revenues from tax.

Secondly, tax-exempt publishers challenged the Regulation for establishing a "presumption" or "*per se* rule" that all commercial advertising, regardless of its nature, is necessarily unrelated to the publishing organization's tax-exempt goals.[4] These groups contended that ads for products and services within their

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[4] See, *e.g.*, *House Hearings* 928 (American Radio Relay League) (Regulation "indicate[s] that advertising is unrelated per se to an exempt purpose"); *id.* at 1113 (American College of Physicians) ("The new Treasury regulations have the effect of conclusively presuming that advertising income derived from the [C]ollege's publication constitutes taxable * * * income."); *id.* at 1118 (American Psychiatric Association) (Regulation "presumes that any advertising in trade and professional journals is 'unrelated' to the purposes of the organization"); *id.* at 1192 (American Ceramic Society) (Regulation effects "blanket taxation of all advertising"); *id.* at 1241 (Institute of Electrical and Electronics Engineers) ("The regulations take the position that all advertising income is subject to tax, regardless of its nature."); *Senate Hearings* 1670 (National Association of Life Underwriters) ("the Service ruled * * * that all advertising is to be considered unrelated, ergo, that no advertising can in any way be related to any tax exempt purpose of any exempt organization").

members' area of specialized interest— *e.g.*, laboratory and clinical equipment for public health professionals (*House Hearings* 1404), whirlpool tubs and traction apparatus for physical therapists (*id.* at 1402), and textbooks for teachers (*id.* at 1410, 1412, 1422)— as distinguished from general consumer advertising, "contributed importantly" to their tax-exempt purposes by enhancing their members' professional competence. As one witness explained, "[i]n most scientific journals published by professional associations, advertisements are limited to products and services that are essential to the proper and efficient practice of the profession involved" (*House Hearings* 1213). This "relatedness" theory was embraced by trade and professional groups across the board, some exempt as educational and charitable organizations under Section 501(c)(3), others exempt as business leagues under Section 501(c)(6).[5]

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[5] *E.g.*, *House Hearings* 928 (American Radio Relay League) ("It has long been the policy of the league to accept only advertising of products pertinent to the field of amateur radio communications, products which assist the amateur in his self-training and development of techniques."); *id.* at 1241 (Institute of Electrical and Electronics Engineers) ("IEEE should not be subject to tax on income derived from advertisements of products embodying the latest scientific developments."); *id.* at 1380 (American Association of Petroleum Geologists) ("The advertisers in the BULLETIN are carefully screened and only those advertisements which will update members' knowledge of materials and services related to petroleum geology are selected for inclusion."); *id.* at 1405 (American Society for Information Science) ("the advertising messages are, in effect, an extension of the editorial function itself, in that they inform persons in the information science field of recent innovations, current literature, and professional services offered"); *id.* at 1412 (Association for Childhood Education International) ("advertising of educational books and materials in *Childhood Education* is a vital part of its function of keeping its

Among the chief proponents of this "relatedness" theory were tax-exempt publishers of medical journals. They maintained that ads for drugs and other therapeutic agents furthered their educational goals by helping doctors keep abreast of recent developments. As a spokesman for the AMA put it, "[d]rug advertisements often provide an important step in the process through which the physician becomes educated in the therapeutic value and risks of new drugs" (*House Hearings* 1261). Tax-exempt medical publishers emphasized that such advertising provided reliable information, not only because it was regulated by the FDA, but also because it was screened by the organizations themselves. They maintained that they consistently refused to print any advertisement that did not have a direct bearing on their readers' professional practice.[6]

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members informed of new developments in education"); *Senate Hearings* 1670 (National Association of Life Underwriters) ("the magazine will accept only advertising which describes a service or a product that is of value to the life insurance agent in his capacity as an agent").

[6] See, *e.g.*, *House Hearings* 1111-1112 (American College of Physicians) ("The advertising carried in the *Annals of Internal Medicine* complements the other educational activities of the [C]ollege."); *id.* at 1119 (American Psychiatric Ass'n) (psychiatrists and other physicians "learn in this way about new drugs, indications, and contraindications for their use, and other information of practical value"); *id.* at 1213-1214 (American Dental Ass'n) ("The advertising program in the association's publications * * * is an important service to the practicing dentist."); *id.* at 1260-1261 (American Medical Ass'n) ("Drug advertising alerts and stimulates the physician's interest in new drugs as they become available"); *id.* at 1391 (American Hospital Ass'n) (advertising is "an effective means of keeping this special audience well informed and up to date within their special province"). See also *id.* at 1197 (American College of Obstetricians and Gynecologists); *id.* at 1375 (American Academy of General Practice); *id.* at 1418 (Louisiana Dental Ass'n).

Taxpaying publishers of trade and professional journals, on the other hand, defended the Regulation as a check upon the perceived inequity and anti-competitive effect of affording a subsidy to their tax-exempt counterparts. See, *e.g.*, *House Hearings* 1109 (Nat'l Newspaper Ass'n); *id.* at 1116 (Second-Class Mail Publications); *id.* at 1140 (Associated Construction Publications); *id.* at 1150 (McGraw-Hill Publications); *id.* at 1246 (Fairchild Publications). They maintained that their periodicals, no less than those of their tax-exempt competitors, help keep readers professionally up-to-date. They emphasized that all publishers, whatever their tax status, vie for advertising dollars using the same sales techniques. They noted that taxpaying and tax-exempt publishers regularly run identical ads—indeed, a pair of competing chemical journals had once run 115 identical ads within a space of six months. See *House Hearings* 1145-1151, 1208; *Senate Hearings* 1111-1112. And they urged that if Congress were to carve out any exception for so-called "related" ads, the exception would eventually swallow the Regulation's rule that commercial advertising is subject to tax. As one witness put it, "[t]his would be a wide open, tax-escaping door, and every advertisement would somehow be related" (*House Hearings* 1150).

A number of witnesses spoke on behalf of taxpaying medical journals in particular. They pointed out that they likewise "screened" their ads for accuracy and relevance to the practice of medicine. And they contended that the tax-free status accorded many of their competitors had the effect of artificially depressing the advertising rates they could charge. *House Hearings* 1150-1152, 1176, 1177-1178, 1205-1210. One witness estimated that drug houses and medical equipment manufacturers in 1968 had spent more than $100 million to promote their products, up to $30 million of which went to tax-exempt publishers. *House Hearings* 1205-1206.

The evidence before Congress showed that the *Journal of the American Medical Association* (which is published by a tax-exempt organization) alone accounted for $10.5 million of that total—the largest advertising revenue of any trade or professional journal in the country (*Senate Hearings* 1088). Indeed, contemporary newspaper accounts noted that the AMA's journal in 1963 "carried 5,262 pages of ads, more than any other national weekly magazine except the New Yorker and the Oil & Gas Journal." Wall St. J., July 24, 1964, at 1, col. 6.

3. In the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 *et seq.*, Congress resolved the controversy by endorsing the Regulation and paving the way for its enforcement. Congress added to the Code new Section 513(c), entitled "Advertising, Etc., Activities." It provides that the term "trade or business" includes any activity "carried on for the production of income," and that "an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization." Those words, expressly sanctioning "fragmentation" of an activity into exempt-purpose and unrelated-business components, were taken almost verbatim from the 1967 Treasury Regulation promulgated to deal with the commercial advertising problem. Compare I.R.C. § 513(c) with Treas. Reg. § 1.513-1(b), 32 Fed. Reg. 17657 (1967).

The legislative history accompanying Section 513(c) plainly shows that Congress intended to codify the treatment of advertising income prescribed by the 1967 Regulation. The Treasury Department took the position

before Congress that the bill "codifies previously existing Treasury Regulations defining activities such as advertising, which will be treated as unrelated business." *Senate Hearings* 568 (testimony of Assistant Secretary for Tax Policy Edwin S. Cohen). Accord, Staff of Senate Comm. on Finance, 91st Cong., 1st Sess., *Tax Reform Act of 1969, H.R. 13270: Technical Memorandum of Treasury Position* 34 (Comm. Print 1969). The House Report recited that the Regulation "mainly affected the advertising income of publications such as medical journals" and stated that "[y]our committee wants to make clear that such regulations are valid." H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969). The Report then explains the new Section 513(c) as follows (*id.* at 50):

> Because of the ensuing controversy over this problem your committee has decided to deal with the subject by legislation. In general, it is in agreement with the purpose of the regulations. Your committee believes that a business competing with taxpaying organizations should not be granted an unfair competitive advantage by operating tax free unless the business contributes importantly to the exempt function. It has concluded that by this standard, advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore it believes that this income should be taxed.

The Senate Report is equally explicit. It notes the controversy over the 1967 Regulation and continues as follows (S. Rep. 91-552, 91st Cong., 1st Sess. 75 (1969)):

> The committee agrees with the House that the regulations reached an appropriate result in specifying that when an exempt organization carries on an advertising business in competition with other taxpaying advertising businesses, it should pay a tax on

> the advertising income. The statutory language on which the regulations are based, however, is sufficiently unclear so that substantial litigation could result from these regulations. For this reason, the committee agrees with the House that the regulations, insofar as they apply to advertising and related activities, should be placed in the tax laws.

The Report goes on to summarize the language of new Section 513(c), and concludes: "Under this provision, advertising income from publications (whether or not the publications are related to the exempt purpose of the organization) is to constitute unrelated business income to the extent it exceeds the expenses related to the advertising" (S. Rep. 91-552, *supra*, at 75-76). The Treasury was directed to "prescribe regulations indicating the appropriate methods for allocating income and expenses" as between taxable product advertising and tax-exempt editorial content (*id.* at 76).[7]

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[7] The regulations issued pursuant to this directive provide generally that "[u]nder section 513 * * * and § 1.513-1, amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business." Treas. Reg. § 1.512(a)-1(f)(1). They then set forth detailed allocation rules for advertising income and expenses. Treas. Reg. § 1.512(a)-1(f)(2) through (7).

As both the Senate Report and the commentators had predicted, the 1967 Regulation did generate "substantial litigation" (S. Rep. 91-552, *supra*, at 75) concerning its application to tax years antedating Congress's enactment of Section 513(c). Indeed, two courts declared the Regulation invalid as applied to pre-1970 tax years, reasoning that the Treasury previously lacked statutory authority to "fragment" publishing activity into taxable and tax-exempt components. See *Massachusetts Medical Soc'y* v. *United States*, 514 F.2d 153, 154 (1st Cir. 1975); *American College of Physicians* v. *United States*, 530 F.2d 930, 933 (Ct. Cl. 1976). In so holding, the Court of Claims recognized that Congress in 1969

C. In Holding Respondent's Advertising Profits Immune From Unrelated Business Income Tax, The Court Of Appeals Ignored The Legislative History, The Governing Regulation, And The Trial Court's Findings of Fact

Surveying this legislative history, the Federal Circuit concluded that Congress in 1969 had laid down no "blanket rule" (Pet. App. 12a) about commercial advertising in tax-exempt professional journals. The court did not even address the effect of the applicable Treasury Regulation, which Congress had explicitly endorsed. Instead, the Federal Circuit believed that Congress had left the door ajar and consigned to the IRS and the courts a case-by-case, ad-by-ad determination as to whether *some* advertisements in *some* journals are "substantially related" to the publisher's educational purposes (see Pet. App. 13a, 19a & n.23). In overturning the Claims Court's findings, moreover, the court of appeals implied that respondent's advertising is distinguishable in some relevant respect from the common run of advertising with which Congress was obviously concerned. The court erred in each step of its analysis.

1. To begin with, Congress in 1969 quite plainly did adopt a "blanket rule" that commercial advertising profits of professional journals are subject to unrelated business income tax. The 1967 Treasury Regulation, which Congress explicitly approved and determined to "place[ ] in the tax laws" (S. Rep. 91-552, *supra*, at 75), was uniformly interpreted, both by the leading commen-

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"prospectively amended [Section 513] to validate the 1967 regulations," and it accordingly limited its decision to tax years before the effective date of that enactment (530 F.2d at 930-931 n.2). The taxpayer in the First Circuit case—like respondent, a tax-exempt publisher of a medical journal—"acknowledge[d] that its advertising activities [came] within the new regulations' definition of an unrelated trade or business" (514 F.2d at 154).

tators at the time [8] and by witnesses who tried to persuade Congress not to endorse it,[9] as creating a presumption or blanket rule to that effect. After all, the Regulation unequivocally states that "the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute." Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7). And Congress made clear that, under the statutory standard it was adopting, "advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore * * * this income should be taxed" (H.R. Rep. 91-413, *supra*, at 50). Although the blanket rule that Congress enacted may admit of exceptions,[10] Congress

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[8] See, *e.g.*, Lehrfeld, *supra*, at 355 (" *per se* rule"); Weithorn & Liles, *supra*, 45 Taxes at 806 ("*all* journal advertising constitutes unrelated business") (emphasis in original); Middleditch & Webster, *supra*, at 175 ("Under the new Regulations, all advertising in an organization publication is now taxable"); Webster, *supra*, 23 Tax Law. at 476 (effect of Section 513(c) is "[t]o tax all commercial advertising income"); Sugarman & Vogt, *The New Advertising Regulations and Their Application to Exempt Organizations*, 54 Taxes 196 (1976) ("By statute gross advertising income from a periodical of an otherwise tax-exempt organization is subject to * * * tax.").

[9] See, *e.g.*, *House Hearings* 928 (Regulation "indicate[s] that advertising is unrelated per se"); *id.* at 1113 (Regulation "conclusively presum[es]" that advertising is unrelated); *id.* at 1118 (Regulation "simply presumes" that advertising is unrelated); *id.* at 1192 (Regulation effects "blanket taxation of all advertising"); *id.* at 1241 (Regulation takes position "that all advertising income is subject to tax, regardless of its nature"); *Senate Hearings* 1670 (Regulation means "that no advertising can in any way be related"); *id.* at 1716 (Regulation "presumes" that advertising is unrelated).

[10] The chief exception recognized by the Treasury Department, an exception that was before Congress in 1969, concerns advertising published in a student-run campus newspaper, where "solicitation, sale, and publication of the advertising are conducted by students, under the supervision and instruction of the university."

plainly intended that the exceptions would be rare indeed.[11]

There is, moreover, no suggestion anywhere in Section 513(c) or its legislative history that Congress intended the courts to confer ad hoc immunity from the unrelated business income tax depending on their subjective, case-by-case evaluation of how "educational" particular advertisements seem to be. The Regulations do provide, in general, that whether an activity is "substantially related" to an exempt purpose "depends in each case upon the facts and circumstances involved" (Treas. Reg. § 1.513-1(d)(2)). However, Congress and the Treasury Department have definitively undertaken this calculus with respect to professional journal advertising activities in particular, and have determined, as a matter of law, that commercial advertising published in the journal of a tax-exempt professional organization "is not related to the organization's exempt functions, and therefore * * * this income should be taxed" (H.R. Rep. 91-413, *supra*, at 50). There is simply no room for courts to second-guess that determination and thereby defeat the very uniformity and even-handedness of tax treatment that Congress sought to achieve.

Treas. Reg. § 1.513-1(d)(4)(iv)(Example 5). The Example concludes that, under these circumstances, publication of the advertising contributes importantly to the university's educational goals "by means of student instruction of other students in the * * * advertising activities and student participation in those activities." See also Rev. Rul. 76-93, 1976-1 C.B. 170 (recognizing exception for advertisement which contains no commercial message but merely lists a company's name, along with the names of 59 other corporate "patrons," on a single page).

[11] As one commentator put it (rather ironically, as it turns out): "[I]t is arguable [after the enactment of Section 513(c)] that there can still be 'related' advertising. However, the legislative history and intent of the Congress is so clear that the likelihood of this argument prevailing as to any period after December 31, 1969 is very improbable." Webster, *supra*, 23 Tax Law. at 476.

2. In light of the legislative history, the only relevant "factual" question is that posed by the Regulation itself—whether respondent's advertising was *commercial* publicity, *i.e.*, whether it was "designed and selected in the manner of ordinary commercial advertising." Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7). The Claims Court found as a fact that it was. "Example 7," the court noted, "closely resembles the situation here" (Pet. App. 29a). Respondent's advertising "was typical commercial publicity" (*id.* at 28a). Many of the products advertised—products like Valium, Tylenol, Darvon, Robitussin, Maalox, insulin, aspirin, and support socks—were for established products and were repeated from month to month, following the standard commercial practice (*id.* at 28a & n.4, 56a-57a, 62a-63a; J.A. 29a-30a). The design of the ads—the use of "eye-catching" formats, the fact that many were in "bright color" and "covered * * * several pages"—was indistinguishable from that of commercial advertisements generally (Pet. App. 28a). "[M]any [of respondent's] ads were identical to those appearing in medical journals published by non-exempt organizations," any differences in content or format reflecting "the advertiser's marketing strategy rather than their probable importance to the reader" (*id.* at 28a-29a). The layout of respondent's ads—being grouped in "stacks" at the beginning and end of the magazine—again corresponded to standard commercial practice (Pet. App. 29a; J.A. 18a). Respondent's "advertising business * * * was operated in material respects like the advertising business of any other publication"—"[t]hose companies willing to pay for advertising space got it; others did not" (*id.* at 28a, 33a). Respondent's rates were "competitive with those of other medical journals" (*id.* at 25a) and "any educational function [respondent's advertising] may have served was incidental to its purpose of raising revenue" (*id.* at 30a). These factual findings

amply justified the Claims Court's conclusion that respondent's ads were " 'designed and selected in the manner of ordinary commercial advertising,' " a conclusion which, under the governing Regulation, means that respondent's advertising " 'is not an educational activity of the kind contemplated by the exemption statute' " (Pet. App. 29a, quoting Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)).

The court of appeals did not disagree with any of these basic findings of fact. Indeed, it could scarcely have done so, since most of the facts were stipulated. Rather, without mentioning the Regulation, it rejected the legal standard the Regulation prescribes, holding that the Claims Court had erred in focusing "on the commercial character of the advertising and on the degree of similarity to advertising activity carried on by commercial organizations" (Pet. App. 14a). The court of appeals then proceeded to conduct its own subjective evaluation of whether the ads were "educational." In holding that they were, it relied chiefly on the facts that the ads were "screened with respect to subject matter and * * * accuracy," were restricted to "products and services related to the practice of internal medicine," and served "to inform the physician of recent developments by disseminating information concerning those developments"—an informational function which the court conceded "may well have been secondary to the purpose of raising revenues" (*id.* at 17a, 19a).

The facts on which the court of appeals relied are irrelevant as a matter of law. The advertisements described in Example 7 are also screened, "[f]ollowing a practice common among taxable magazines which publish advertising," to ensure that they "comply with certain general standards of taste, fairness, and accuracy" (Treas. Reg. § 1.513-1(d)(4)(iv)). The advertisements described in Example 7 also "promote only products which are within the general area of profes-

sional interest of [the assocation's] members" (*ibid.*). And the advertisements described in Example 7 also "contain certain information," an informational function which is "incidental to the controlling aim of stimulating demand for the advertised products" (*ibid.*). Notwithstanding these facts, Example 7 concludes that the advertising, because of its *commercial* character, "is not an educational activity" (*ibid.*). Indeed, the Treasury Department went out of its way, by amending the Proposed Regulation after receiving comments from the tax-exempt press, to make clear that "professional interest advertising," for products like drugs and medical devices, and "general consumer advertising," for products like soft drinks and cars, are to be treated identically for purposes of the unrelated business income tax. Compare Prop. Reg. § 1.513-1(d)(4)(iv)(Example 6), 32 Fed. Reg. 5995 (1967), with Treas. Reg. § 1.513-1 (d)(4)(iv)(Examples 6 and 7), 32 Fed. Reg. 17659 (1967).

The facts upon which the court of appeals relied are also precisely the same facts that spokesmen for the tax-exempt press repeatedly emphasized before Congress in 1969 in an unsuccessful effort to have the Regulation legislatively overruled. See pages 20-22 & notes 5-6, *supra*. Pharmaceutical product advertising was at the core of the problem Congress addressed. Witness after witness testified, just as respondent's witnesses testified below, that ads in medical journals are "educational" because they perform a valuable "alerting function," provide information about "new drugs, indications, and contraindications for use," and keep doctors "well informed and up to date." Compare, *e.g.*, *House Hearings* 1119, 1260-1261 & 1391 with J.A. 27a-28a, 37a, 40a, 43a. Congress was unpersuaded by their testimony. It expressly approved the Regulation, noting that it "mainly affected the advertising income of

publications such as medical journals" (H.R. Rep. 91-413, *supra*, at 44), and determined that the regulations, "insofar as they apply to advertising and related activities, should be placed in the tax laws" (S. Rep. 91-552, *supra*, at 75). A long line of this Court's decisions confirms that interpretive rulings by the Treasury, "if found to 'implement the congressional mandate in some reasonable manner,' must be upheld." *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 476 (1979) (quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973)). And here the Regulation not only implements the congressional mandate, but was specifically endorsed by Congress when it enacted the mandate in question. See *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381-382 (1969).

D. There Is No Merit To Respondent's Argument That The Principles Of Example 7 Of The Regulation Apply Only To Publishers Exempt Under Section 501(c)(6), To The Exclusion Of Publishers Exempt Under Other Subsections of Section 501(c)

Respondent appears to have recognized early in this litigation that its advertising is indistinguishable from that described in Example 7 of the Regulations, and hence that it could not prevail if the principles of that Example were he' dispositive. In its complaint, respondent alleged that the Regulation was invalid. J.A. 8a. That argument, however, would have required proof that the Regulation was inconsistent with the statute—an awkward undertaking, since Congress had expressly approved the Regulation in 1969. Respondent shifted gears in its pretrial brief and contended that the Claims Court need not consider the validity of Example 7, on the theory that the principles of that Example apply only to tax-exempt publishers organized as trade associations under Section 501(c)(6), and not to tax-exempt publishers (like respondent) organized as educational associations under Section 501(c)(3). Cl. Ct.

Br. 22-25. The Claims Court, while not explicitly addressing this argument, rejected it by implication. See Pet. App. 29a. Respondent raised the argument again on appeal (C.A. Br. 30-31), but the Federal Circuit neither mentioned it nor relied on it as a basis of decision.

Respondent reiterates its contention here (Br. in Opp. 11-13). It notes that the hypothetical organization described in Example 6 of the Proposed Regulation was an "exempt trade association" (32 Fed. Reg. 5995 (1967)), and that the hypothetical organization described in Examples 6 and 7 of the Final Regulation is "an association exempt under section 501(c)(6), formed to advance the interests of a particular profession" (32 Fed. Reg. 17659 (1967)). Respondent disclaims any challenge to the validity of these Examples (Br. in Opp. 12), conceding that "the IRS may plausibly contend that Example 7 is a shorthand determination that advertising will not have a 'substantial relationship' to an exempt purpose for a [Section 501](c)(6) organization" (*ibid.*). Respondent contends, however, that "[t]he same cannot be said" of charitable or educational organizations exempt under Section 501(c)(3)—or, presumably, of organizations exempt under the twenty-odd other subsections of Section 501(c). In respondent's view, the Treasury's choice of a trade association for use in these two Examples was not accidental or merely illustrative, but reflected a deliberate decision to confine the legal analysis that the Examples set forth to publishers who rely on Section 501(c)(6) as the basis for their tax exemption. This argument is altogether meritless.

1. Section 501(c)(6) provides an exemption inter alia for "[b]usiness leagues" and "boards of trade." In order to qualify for exemption under that subsection, an organization's activities must be "directed to the improvement of business conditions of one or more lines of

business." Treas. Reg. § 1.501(c)(6)-1. See *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472 (1979). Providing educational services to members on subjects germane to their professional interests is among the purposes that may qualify an association for exemption as a "business league." *E.g.*, *National Leather & Shoe Finders Ass'n* v. *Commissioner*, 9 T.C. 121 (1947). See generally *Louisiana Credit Union League* v. *United States*, 693 F. 2d 525, 535-536 (5th Cir. 1982). Thus, the trade association described in Example 7 is said to have "continuing education of its members in matters pertaining to their profession" as one of its exempt purposes, and the publication of articles in its monthly journal is said to "contribute importantly to the accomplishment" of those educational objectives. Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7).

A professional association like respondent, whose members are drawn from a single profession and which has broad educational or charitable goals, generally has the option of qualifying for tax exemption *either* as an educational association under Section 501(c)(3) *or* as a business league under Section 501(c)(6). The chief differences are pragmatic. Section 501(c)(3) groups may receive donations that are deductible by individual donors as charitable contributions, whereas business leagues may not. See I.R.C. § 170(c)(2). Section 501(c)(3) groups, on the other hand, may not engage in political campaign activity or in substantial lobbying without forfeiting their tax exemption, while business leagues do not operate under those constraints. Compare I.R.C. § 501(c)(3) with I.R.C. § 501(c)(6).[12] Thus, the form of

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[12] The relationship between Sections 501(c)(3) and 501(c)(6) as possible bases of classification for tax-exemption purposes has long been troublesome. See generally *Better Business Bureau* v. *United States*, 326 U.S. 279 (1945).

tax exemption chosen by a professional association like respondent will typically depend on funding considerations and on the intended scope of its activites. Respondent and the American Psychiatric Association, for example, both of which publish scholarly medical journals for their members, are exempt under Section 501(c)(3). The American Medical Association and the American Dental Association, which likewise publish scholarly medical journals for their members, are exempt under Section 501(c)(6).

2. Respondent's attempt to posit a dichotomy in the treatment of advertising income, depending on whether the publishing organization is exempt under Section 501(c)(3) or Section 501(c)(6), is utterly unprecedented. In the long, detailed history of this issue, we know of no instance in which the IRS, the Congress, a court, or a commentator has suggested that the principles of Example 7 are confined to advertising published by Section 501(c)(6) organizations, to the exclusion of advertising published by other tax-exempt groups. In announcing the Proposed Regulation, the IRS said that it was designed "to make it clear that the unrelated business income tax applies to profits which *exempt organizations* derive from the sale of advertising in periodicals which they publish" (TIR-899, *supra* (emphasis added)). Commentators discussing the Proposed Regulation uniformly characterized it as creating a "*per se* rule" (Lehrfeld, *supra*, 23 Tax Law. at 355) that "*all* journal advertising constitutes unrelated business" (Weithorn & Liles, *supra*, 45 Taxes at 806 (emphasis original)). Leaders of the unsuccessful campaign to block the Regulation on the floor of Congress in 1968 described it as imposing a tax on the advertising profits of "fraternal" organizations (exempt under Section 501(c)(8)),

"educational" organizations (exempt under Section 501(c)(3)), "trade" organizations (exempt under Section 501(c)(6)), and "labor organizations" (exempt under Section 501(c)(5)). See 114 Cong. Rec. 7879 (1968).

At the hearings in 1969, Congress heard testimony from spokesmen for numerous Section 501(c)(6) groups (such as the American Medical Association, the American Dental Association, and the American Physical Therapy Association) and from numerous Section 501(c)(3) groups (such as the American Psychiatric Association, the American Osteopathic Association, and respondent). These spokesmen analyzed Example 7 in detail; at no point did they suggest that the taxability of advertising revenues from their medical journals would depend on the particular subsection of Section 501(c) under which they happened to be organized. Indeed, respondent's own witness testified that "[t]he new Treasury regulations have the effect of conclusively presuming that advertising income derived from the [C]ollege's publication constitutes taxable * * * income," and that the Regulation was "designed so as to preclude even the possibility that advertising which appears in the *Annals* can ever 'contribute importantly' to the [C]ollege's charitable function" (*House Hearings* 1113). Congress recited that the Regulation it aimed to codify had "mainly affected the advertising income of publications such as medical journals" (H.R. Rep. 91-413, *supra*, at 44) and stated that, under the statutory standard it was then adopting, "advertising in a journal published *by an exempt organization* is not related to the organization's exempt functions" (*id.* at 50 (emphasis added)). Congress drew no distinction on that score between different species of tax-exempt groups that publish advertising for profit.

Commentators discussing the effect of Congress's enactment in 1969 of Section 513(c) have concluded that "advertising income from a periodical *of an otherwise tax-exempt organization* is subject to the unrelated business income tax." Sugarman & Vogt, *supra*, 54 Taxes at 196 (emphasis added; footnote omitted). Neither court below accepted, or even mentioned, respondent's suggestion that tax-exempt publishers should receive differential tax treatment depending on the source of their exemption. And commentators who have considered respondent's argument since the decision below was issued agree that the attempted distinction is meritless. See Weinberg & Nixon, *What Are The Implications of the Federal Circuit's Holding in American College?* 62 J. Tax. 242, 243 (1985) ("[I]t may be that the court [of appeals] viewed Example 7 as inapplicable to a 501(c)(3) organization, but nothing in Example 7 suggests [that] such a restrictive application was intended by the Treasury.").

Respondent's argument, moreover, makes no sense as a construction of the Regulation. While it is true that there are some "differences in purposes" (Br. in Opp. 12) between Section 501(c)(3) groups and Section 501(c)(6) groups, those differences, in the case of professional associations like respondent, are usually slight (see pages 35-36, *supra*), and in any case are irrelevant in this context. The trade association described in Example 7 has among its exempt purposes the "continuing education of its members in matters pertaining to their profession," and the Example concludes that its publication of commercial advertising "is not an educational activity" (Treas. Reg. § 1.513-1(d)(4)(iv)(Example7)). Respondent also has among its exempt purposes the continuing education of its members in matters pertaining to their profession, and respondent publishes commercial advertising substantially identical to that described in the Example. It is the educational charac-

ter vel non of the *advertising* that determines whether the resulting revenues are subject to unrelated business income tax. It can scarcely be contended that the advertising described in Example 7 would become more "educational" simply by virtue of being published by an organization claiming exemption under Section 501(c)(3). Either the advertising is "educational" or it is not.

Respondent's suggested distinction, finally, makes nonsense of the policy of the unrelated business income tax. Congress enacted that tax, and amended it in 1969 specifically to bring advertising revenues within its scope, in order to prevent tax-exempt groups from obtaining an unfair advantage over their taxable competitors in the marketplace. On respondent's theory, revenues from a drug ad run in the journal of the American Medical Association, a Section 501(c)(6) group, would be subject to tax, while revenues from an identical drug ad run in its own journal would be exempt from tax, simply because it chose to be organized under Section 501(c)(3). The provenance of respondent's tax exemption, however, makes no difference to the taxpaying publishers with which it competes, and respondent's theory would perpetuate the unfair competition that Congress in 1969 aimed to stop. Indeed, respondent's theory would exacerbate the problem, for it would enable some tax-exempt publishers to compete unfairly, not only with taxpaying publishers, but with other tax-exempt publishers as well. And since a professional association like respondent can generally choose to be organized under either Section 501(c)(3) or Section 501(c)(6), respondent's theory in effect would make the payment of tax on advertising profits *elective*, a result that Congress would surely find rather surprising.

Accordingly, there is no merit to respondent's argument that the principles of Example 7 do not apply to it. It will not do for respondent to posit an erroneous distinction, suggest that the court of appeals, by its silence, "obviously agreed" with it (Br. in Opp. 13), and thereby excuse that court for ignoring a Regulation that Congress explicitly approved and that precisely describes the situation here.[13]

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[13] Contrary to respondent's contention (Br. in Opp. 5-6, 12, 14 n.20), Example 5 of the Regulation provides no support for its position. As noted above (pages 28-29 note 10, *supra*), that Example concerns advertising published in a student-run campus newspaper, where "solicitation, sale and publication of the advertising are conducted by students, under the supervision and instruction of the university" (Treas. Reg. § 1.513-1(d)(4)(iv)(Example 5)). The Example concludes that "the advertising business contributes importantly to the university's educational program through the training of the students involved" (*ibid.*). Noting that Example 5 involves a university, a Section 501(c)(3) organization, respondent regards it as standing for the general proposition that advertising published by Section 501(c)(3) groups, as contrasted with advertising published by Section 501(c)(6) groups, is substantially related to educational purposes. See Br. in Opp. 12, 14 n.20; C.A. Br. 30-31; Cl. Ct. Br. 22-25. This argument is frivolous. Example 4, the immediately preceding Example, also involves a Section 501(c)(3) group, one organized to advance "public interest in classical music," which owns a radio station; Example 4 concludes that the station's revenues "from the regular sale of advertising time and services to commercial advertisers in the manner of an ordinary commercial station" are taxable as unrelated business income. Treas. Reg. § 1.513-1(d)(4)(iv)(Example 4). Accord, Rev. Rul 76-93, 1976-1 C.B. 170 ("conventional" commercial advertising published by Section 501(c)(3) group is unrelated to its exempt purposes); Rev. Rul. 72-431, 1972-2 C.B. 281, 282 (same). In all these instances, it is the similarity vel non of the advertising to *commercial* advertising, not the subsection of Section 501(c) under which the publisher happens to be organized, that determines the taxability of the advertising profits. Respondent's theory would yield the absurd result that a Section 501(c)(3) group's *radio* advertising profits (Example 4) are taxable, while its *print* advertising profits (Example 7 supposedly being inapplicable) are not. Neither the IRS nor Congress can rationally be thought to have intended such an outcome.

E. Reversal Of The Decision Below Is Supported By Strong Considerations Of Tax Policy, Administrative Convenience, And Common Sense

The Federal Circuit has invalidated sub silentio longstanding Treasury Regulations that Congress considered in 1969 and upon which it placed its specific imprimatur. In so doing, the court has reopened the tax "loophole" (114 Cong. Rec. 27785 (1968)) that Congress, sixteen years ago, took no little trouble to close. The court of appeals' reasoning can be pressed into service by hundreds of tax-exempt professional and trade journals nationwide. Associations of chemists, engineers, geologists, and water pollution experts, no less than of doctors, can plausibly argue (as they argued to Congress in 1969) that their members' professional competence is enhanced by updated information contained in advertisements for new products and services. Indeed, the tax-exempt press has hailed the court of appeals' holding as "undoubtedly a landmark decision" that may enable "many non-profit associations * * * to establish that their journal advertising is substantially related to exempt purposes and not subject to taxation." 22 *Non-Profit Organization Tax Letter* No. 13, Oct. 5, 1984, at 3. As one witness put it during the 1969 congressional hearings, the subjective, ad-by-ad approach adopted by the court below "would be a wide open, tax-escaping door, and every advertisement would somehow be related." *House Hearings* 1150.

The decision below, however, has repercussions far beyond the tax revenue at stake. The unrelated business income tax has a significant regulatory function. Congress designed the tax, not just to raise money, but to keep the commercial endeavors of exempt and non-exempt competitors on a par. By permitting respondent to operate its commercial advertising business tax-free, while its business rivals must pay tax, the court of appeals has flouted this sharply-defined legislative policy.

The practical consequences of the court's open-ended reasoning, moreover, would entail formidable burdens on IRS audit resources. Under the heretofore unquestioned rule that "advertising designed and selected in the manner of ordinary commercial advertising" is subject to tax (Treas. Reg. § 1.513-1(d)(4)(iv)(Example 7)), IRS examiners were not required to investigate the "educational" function of advertisements on an ad-by-ad basis. The agent's task was simply to identify the advertising generally as being for *commercial* products or services. Under the decision below, by contrast, IRS agents would apparently have to figure out, on a case-by-case basis, which commercial advertisements "contribute importantly" to the publisher's exempt function and which do not.[14] As a witness testified before Congress in 1969, "[t]o draw the line on an individual basis * * * and to say that this is advertising which is unrelated and that [that is] advertising [which] is related would present to the IRS[,] and taxpayers generally, an almost insurmountable audit problem." *House Hearings* 1184 (American Society of Association Executives). The existing Treasury approach, by establishing that *commercial* advertising is unrelated per se to exempt purposes, produces logical tax consequences and prevents

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[14] The court of appeals, for example, highlighted an advertisement placed in *Annals* for *Medical Economics* (Pet. App. 60a), a magazine that "help[s] provide [doctors with] answers to such questions as whether 'the new Seville [is] worth its $12,479 base price' " (Pet. App. 32a n.7), and suggested that it would not qualify as "substantially related" to the College's educational function. See *id.* at 19a and n.23. But would the same be said about an ad placed by an interior decorating firm that specializes in doctors' offices? And does a drug ad serve an educational purpose when the product is widely known and has been available (say) for 15 years? The court of appeals' analysis is of such uncertain dimensions that it suggests no answers to questions like these.

journals from manipulating the tax outcome by advising their advertisers to insert incidental "educational" boilerplate in their ads. The court of appeals has discarded that analysis and has provided no workable standard to take its place.

The court of appeals' reasoning, finally, does no little violence to common sense. Everyone agrees that "[a]ll advertising is * * * educational or informational to some degree" (Pet. App. 29a). The reason sellers advertise is to communicate a message that they want buyers to hear. And everyone agrees that respondent engages in a proper—indeed, in a highly laudable—activity when it undertakes to keep doctors apprised of new medical developments. To the extent that respondent uses the articles and editorial content of its journal to accomplish that end, the income it realizes (*i.e.*, its subscription and dues income) is unquestionably exempt from tax. But to the extent that respondent uses commercial advertising as the information-conveying vehicle, charging the advertiser a fee as a condition of publishing the ad, the message is plainly that of the advertiser rather than one to which respondent would choose to devote its own, general resources. As Judge Kozinski suggested, respondent in a sense had two options: to "include advertising for its members free of charge" or to "sell advertising as a business * * * and make a profit on it" (J.A. 49a). In choosing the latter option over the former, obviously, respondent was motivated entirely by revenue-raising, and not at all by educational, concerns. Respondent's educational objectives were *of necessity* inconsequential in its decision to publish *commercial* advertising. Congress accordingly determined, as we have shown, that respondent should pay tax on its commercial advertising profits just as any other publisher would have to do.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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No. 84-1737

IN THE

SUPREME COURT OF THE UNITED STATES

UNITED STATES OF AMERICA,

Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS,

Respondent

On Writ of Certiorari to The United States Court of Appeals for the Federal Circuit

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Question Presented

The Internal Revenue Code imposes a tax on the income which a tax-exempt organization receives from trade or business activities that are not "substantially related" to the purposes or functions constituting the basis for its exemption, defined in the Treasury Regulations as activities that do not "contribute importantly" to its exempt purpose. The question presented is:

Whether income from advertisements in the scholarly journal of an exempt association of physicians, organized for charitable, scientific and educational purposes under section 501(c)(3) of the Code, is subject to the unrelated business income tax, where the advertisements relate solely to the practice of internal medicine, are uniquely informative, and are indisputably shown to contribute importantly to the association's exempt function of improving health care.

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No. 84-1737

IN THE

SUPREME COURT OF THE UNITED STATES

UNITED STATES OF AMERICA,

Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS,

Respondent

On Writ of Certiorari to The United States Court of Appeals for the Federal Circuit

BRIEF FOR RESPONDENT

STATEMENT

This action involves a claim for refund of federal income taxes paid by respondent The American College of Physicians, Inc. ("the College") on income received in 1973 from the publication of specialized advertising in its scientific journal, *Annals of Internal Medicine* ("*Annals*"). The issue is whether the advertising in *Annals* is "substantially related," *i.e.*, "contributes importantly," to the charitable, educational and scientific purposes constituting the basis for the College's exemption. Resolution of that issue requires consideration of (a) the exempt functions or purposes of the College, (b) the advertising activity in question, and (c) the contribution of the advertising activity to the exempt functions.

A. The purposes and functions underlying the College's exemption under section 501(c)(3).

The College is a membership corporation exempt pursuant to section 501(c)(3) of the Internal Revenue Code (the "Code"), which covers entities organized and operated exclusively for charitable, scientific, and kindred purposes (J.A. 16a).[1] The College's tax-exempt purposes are, *inter alia*, (1) to foster measures for the prevention of disease and for the improvement of public health; (2) to encourage research, especially in clinical medicine; and (3) to uphold and to maintain high standards in medical education and medical practice (J.A. 16a).

In furtherance of its exempt purposes, the College engages in a variety of activities directed to improving health care by physicians by sponsoring an annual comprehensive postgraduate session, other international and regional educational programs, and continuing education for member physicians (J.A. 21a). The College also sponsors a public education program on health-related issues, develops self-assessment examinations for its members, sets standards for internal medicine training programs, assesses tests and procedures used by practitioners, and comments on matters of public policy affecting internal medicine (J.A. 21a-24a). As part of these efforts, since 1927 the College has published *Annals*, which contains scholarly articles relevant to internal medicine and is generally considered the preeminent medical journal in that field (J.A. 17a, 22a, 38a).

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1. Section 501(c)(3) confers tax-exempt status on

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals . . . .

Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954, as amended. Unless otherwise specified, all references to the Code and the regulations promulgated thereunder are to provisions that were in effect in 1975.

B. The uniquely informative nature of the advertising in *Annals*.

Each monthly issue of *Annals* contains limited advertising which is relevant to the practice of internal medicine (J.A. 17a). The vast majority[2] are specialized ads for prescription drugs (J.A. 17a).[3]

Prescription drug ads are unique in that they are directed only at physicians, who occupy a legally acknowledged role as "learned intermediaries,"[4] rather than to the ultimate consumer,[5] and their content is largely mandated by the government. In 1962 Congress enacted legislation regulating the content of prescription drug ads and authorizing the Food & Drug Administration ("FDA") to mandate the information required to be included. 21 U.S.C. § 352(n). In 1963 FDA adopted generalized implementing regulations. 28 Fed. Reg. 6376 (1963). Effective in 1968, FDA promulgated more extensive regulations specifying the required and prohibited editorial content of prescription drug ads, involving, *inter alia*, prior FDA approval (mandatory in some circumstances, voluntary in others) and "true" and "fairly balanced" statements about such matters as side effects and contraindications. *See* 33 Fed. Reg. 9393 (1968) (now codified as amended at 21 C.F.R. § 202.1 (1985)). The government has described these as "the most stringent adver-

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2. *See, e.g.*, Exh. P-1 (January 1975 issue of *Annals*) (J.A. 45a); Respondent's Brief in Opposition to Petition for Writ of Certiorari p. 4 n.4.

3. The advertisements are concentrated (or "stacked") in two sections to the front and rear of the editorial copy, and are indexed (J.A. 17a). This stacking permits the physician to review all of the ads in a convenient location, and also avoids having the articles interrupted by ads which may not relate directly to them. The College sets the rates charged for advertising in *Annals* by reference to its publication costs, at a level comparable to rates set by other medical journals (J.A. 18a).

4. *See, e.g., Reyes v. Wyeth Labs.*, 498 F.2d 1264, 1276 (5th Cir.), *cert. denied*, 419 U.S. 1096 (1974).

5. The longstanding practice of not directing prescription drug advertising to consumers has been reinforced by a voluntary "moratorium" on such advertising imposed at the request of the FDA. Food Drug Cosm. L. Rep. (CCH) ¶ 42,879 (1983).

tising regulations for any product in commerce. . . . Every single advertisement for every FDA-approved drug is reviewed not only for the words it contains, but for its overall impact."[6]

The College maintains a strict policy, predating the FDA requirements,[7] of screening each proferred advertisement for accuracy and relevance to internal medicine, and has rejected advertisements of products which do not conform to its guidelines (J.A. 17a, 32a-33a).

C. The substantial importance of prescription drug advertising to the improvement of health care

For practitioners of internal medicine, advertising for prescription drugs in medical journals such as *Annals* has long been recognized as playing a crucially important role. This role was documented at trial by the uncontradicted testimony of Drs. Robert Moser, Edward Rosenow, Louis Lasagna and Stuart Bondurant.

Dr. Moser, formerly Chief of Medicine at Walter Reed Medical Center, a practicing internist, and currently Executive Vice President and a Fellow of the College, testified that the primary function of the College "is medical education of internists" with "the ultimate bottom-line hope . . . that this will provide better patient care [through] the efforts of these internists" (J.A. 20a). Dr. Moser (and the other expert witnesses) testified that the specialized limited product advertising carried in *Annals* was essential toward attaining this result by providing an efficient means of disseminating information concerning drugs and treatments to practicing physicians (J.A. 26a-28a). Dr. Moser characterized the advertising in *Annals* as "basically from

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6. Letter of Arthur Hull Hayes, Commissioner of Food & Drugs, to Rep. John P. Dingell, May 19, 1982. A sample ad is appended to the College's Brief in Opposition to the Petition.

7. Prior to the FDA requirements, the College maintained a body of volunteer physicians whose function was to check proffered ads for medical accuracy and thoroughness (J.A. 32a-33a).

pharmaceutical companies that . . . recently had a new drug released by FDA and want to let the profession know very quickly that the drug is now available" (J.A. 26a). Additionally, he testified that drug advertising was common when FDA approved a new indication for an already established drug (J.A. 26a).[8] As for both categories, Dr. Moser reiterated the College's position toward the inclusion of advertising expressed in a July 1977 editorial in *Annals*:

> Drug advertisements in peer-review journals are a vital part of continuing pharmacologic education. Since the Food and Drug Administration has imposed guidelines that limit advertising copy to content that does not extend beyond package-insert information, "truth in advertising" is not an issue . . . .
>
> No one, including the advertisers, expects that any good clinician will leap up and dash off reams of prescriptions on the basis of an appealing advertisement. But it does serve an alerting function: to provoke the physician's interest to the extent that he will look further into the drug's use by reading a contemporary pharmacologic text, or ask his librarian to reproduce a few references from current journals, or look it up in *The Medical Letter* or *AMA Drug Evaluations*. This

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8. The government notes that a few of the ads in *Annals* in 1975 were for "well-known and established products" like Insulin and Maalox, a fact said to undermine the proposition that one purpose of such ads was to alert readers to new developments (Gov't Br. 6). The government failed at trial to establish what it seeks in this Court to imply, i.e., that there had been no pertinent developments concerning such products. In fact, both of these products had undergone significant changes which extended their benefits to more potential users. During 1973, for example, U-100 Insulin was introduced, a single concentration suitable for most insulin-dependent diabetics. The new concentration was expected to completely replace pre-existing forms of the drug and to reduce the frequency of mistakes in dosage resulting from patient error. During 1975, Maalox introduced a new formulation which made it palatable to more antacid users. *See* 78 *Annals of Internal Medicine* No. 2, pp. 33-34 (1973); 82 *Annals of Internal Medicine* No. 5, pp. 86-87.

> catching of the reader's attention is a short but important step down the trail of education on drug use to more enlightened prescribing habits. [J.A. 26a-27a, 59a-60a].[9]

He characterized the alerting function of the ads in *Annals* as "most valuable." (J.A. 28a).

Dr. Rosenow, a Fellow of the College who was its Executive Director in 1975,[10] testified that "the half-life of medical knowledge is about five or six years," creating a pressing need for an accurate means to update and expand the knowledge of the College's member physicians (J.A. 34a). He said that a survey of the College's members concerning inclusion of ads in *Annals* had resulted in a "very strong and positive reaction;" members found the ads "very informational and educational" (J.A. 33a-34a).

Dr. Lasagna[11] confirmed that, particularly in the areas of available drugs and diagnostic procedures, the knowledge acquired during a physician's formal education became "increasingly out of date as the years went by" (J.A. 37a). Dr. Lasagna attributed this state of affairs to advances in new drug development, changes made over time in dosage forms and strengths of existing drugs, and additional indications and contraindications discovered in approved drugs after widespread use (J.A. 37a). Dr. Lasagna testified that drug advertising such as that carried in *Annals* was essential to disseminate information concerning all these developments (J.A. 38a). He characterized the editorial and advertising segments of *Annals* as being in a

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9. Toward this end, during 1975 the College published notices in *Annals* specifically requesting its readers to study the advertising as a means of keeping abreast of recent medical developments (Exh. P-4, at I-110).

10. Following his training at Harvard Medical School and the Mayo Clinic, Dr. Rosenow practiced internal medicine for nearly 20 years and then was a clinical professor at the University of Southern California and the University of Pennsylvania (J.A. 31a).

11. At the time of trial, Dr. Lasagna was Professor of Pharmacology and Medicine at the University of Rochester School of Medicine. Prior to that, he served as chairman of that department, and previously as organizer and head of the Division of Clinical Pharmacology at Johns Hopkins School of Medicine (J.A. 36a-37a).

"point-counterpoint relationship" and "interacting in an important way in trying to keep doctors up-to-date." He had "no doubt" that they "contribut[ed] importantly to keeping the doctors up to date" (J.A. 38a).

Dr. Bondurant[12] testified that medical education, rather than seeking to impart a fixed body of knowledge, is directed at equipping physicians for the continuous acquisition and critical appraisal of new information over a lifetime of practice (J.A. 42a). Particularly important to him was the internist's need for up-to-date knowledge of developments in the treatment of diseases through drugs (J.A. 43a). Dr. Bondurant restated the important and non-redundant role of drug and medical product advertising in fulfilling this need, and testified that medical training encouraged students to review ads contained in journals such as *Annals* (J.A. 43a-44a).[13]

D. The College's first successful challenge to IRS' attempt to tax its advertising income.

After paying taxes on its advertising income in 1968 and 1969, the College sought a refund in the Court of Claims, arguing that regulations of the Internal Revenue Service ("IRS") adopted in 1967, which required the "fragmentation" of its publishing activities into editorial matter and advertising, each to be treated separately for purposes of determining whether it was "related" (*see* p. 18 *infra*), were invalid as beyond the scope of the Code provisions they purported to implement. The Court of Claims agreed. *American College of Physicians v. United States*,

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12. Dr. Bondurant is Dean of the School of Medicine of the University of North Carolina at Chapel Hill. Prior to assuming that position, he served as president and dean of Albany Medical Center, chairman of the Department of Medicine at Albany Medical College, and as a professor at the University of Indiana School of Medicine (J.A. 41a). He is also a past Vice President and President of the College (J.A. 42a).

13. FDA regards prescription drug ads as constituting "post-graduate education." Address by FDA Commissioner James L. Goddard, Advertising and Government Relations Conference, Washington, D.C., Feb. 8, 1967, in Food Drug Cosm. L. Rep. (CCH) ¶ 80,161 (1967).

530 F.2d 930 (Ct. Cl. 1976) ("*ACP I*"); *accord*, *Massachusetts Medical Society v. United States*, 514 F.2d 153 (1st Cir. 1975).

On the premise that advertising could be fragmented from its editorial context, in *ACP I* the government argued (as it does here) that Example 7 of the regulations embodied a *per se* rule which made it unnecessary to resolve the factual dispute about whether the advertising in *Annals* contributed importantly to the College's exempt purposes so as to be "substantially related" thereto. (Trial Brief of the United States pp. 13-14). In that case the College responded, as here, that any *per se* rule in Example 7 was confined to organizations exempt pursuant to section 501(c)(6),[14] to which Example 7 specifically refers, and that, even if there could be fragmentation, the case presented a factual issue as to whether the ads contributed importantly to the College's exempt purposes. Accordingly, the College submitted affidavits showing, *inter alia*, that the advertising in *Annals* constituted an "abbreviated medical textbook article on the specific drug" advertised, and hence contributed importantly to the College's exempt purposes under section 501(c)(3); the government offered affidavits to the contrary. 530 F.2d at 931 n.3.

Finding dispositive its decision that the "fragmentation" regulation was invalid "irrespective of whether the advertisements themselves are or are not substantially related to plaintiff's exempt purpose," the Court of Claims agreed that if the ads could be fragmented the case would present an "essentially factual dispute" as to whether they were "related." *Id*. This characterization necessarily rejected the government's *per se* approach.[15]

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14. Exemption pursuant to section 501(c)(6) is granted to "[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

15. By the time *ACP I* was decided, Congress in 1969 had amended section 513(c) to endorse the concept of "fragmentation" in the 1967 regulations (see pp. 22-25 *infra*), yet the *ACP I* court obviously did not regard the regulations or Congress' action as establishing a *per se* rule.

E. The instant litigation.

For taxable year 1975, the College paid $55,965 in taxes on income from its publications, and thereafter sought a refund of those taxes (J.A. 16a). The College timely filed a petition for refund with the Claims Court, alleging, as it had in *ACP I*, that the advertising in *Annals* was "substantially related" to its exempt purposes, and therefore exempt from tax (J.A. 6a-9a).

In response to the College's testimony (see pp. 4-7 *supra*), the government conducted minimal cross examination and offered no rebuttal testimony. Nevertheless, the Claims Court concluded that the advertising in *Annals* was not "substantially related" to any exempt purpose of the College and thus was taxable (Pet. App. 30a). The trial court, while employing a factual analysis and not a *per se* rule, concluded that the advertising had a predominantly commercial nature which precluded it from contributing importantly to the purposes underlying the College's exemption (Pet. App. 29a-30a).

On appeal, the United States Court of Appeals for the Federal Circuit reversed. In an opinion by Judge Edward Smith,[16] the court of appeals agreed, as both sides had argued, that the Claims Court had correctly viewed the issue as factual, but held that the trial court's resolution of the relatedness issue against the College was clearly erroneous for the undue weight given to the commercial aspects of the ads. The court of appeals held that the trial court had imposed too rigorous a standard, by placing "too great an emphasis on the similarity of the activity to commercial advertising" (Pet. App. 16a). The statute, the court held, provides that the determinative factor is the importance of the contribution of an activity to the performance of an organization's exempt functions, rather than the commercial character of the activity (Pet. App. 16a).

Reviewing the pertinent legislative history, the court of appeals found no basis in the statute for the proposition that Congress had declared that advertising in professional journals was

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16. Judge Smith is a former tax attorney both in private practice and in the Tax Division of the Justice Department.

unrelated. Rather, after analyzing the regulations, the court concluded that advertising, like every other activity, was subject to the factual analysis dictated by the statute and regulations to determine whether it was "substantially related" and "contributed importantly" to an exempt purpose (Pet. App. 12a-13a). It found that the advertising in *Annals* in fact contributed importantly to the College's exempt purposes under section 501(c)(3).

SUMMARY OF ARGUMENT

The government asks this Court to rewrite the tax laws to set forth a rule that Congress declined to adopt and which the Treasury has not provided in its regulations. Like the court of appeals, the Court should decline the invitation.

The ultimate issue in this case is whether the advertising in *Annals* is "substantially related" to the charitable, scientific, and educational purposes underlying the College's exemption as a public-service organization under section 501(c)(3) of the Code. The Code, the Treasury regulations, and a prior court decision involving the College all treat that question as presenting a "factual" dispute, as did the parties and both courts below in this case.

The undisputed record evidence, much of it through stipulation, demonstrates that the advertising in *Annals* relates exclusively to the practice of internal medicine, is predominantly for prescription drugs and hence by government mandate is uniquely informative, contributes importantly to the improvement of health care through the continuing professional education of physicians, and is substantially related to its exempt purposes. When the government failed to controvert the College's testimony, it in effect conceded that the advertising in *Annals* does "contribute importantly" to exempt functions of the College. The government now asks this Court to disregard this relevant record evidence, asserts there is no need for a factual analysis, and urges a vaguely framed conclusive presumption or *per se* rule that cannot be founded in the statute, the regulations, nor the case law.

Since its enactment in 1950, section 513(a) has required analysis of whether an activity is "substantially related" to the purposes underlying an organization's exemption. Treasury regulations adopted in 1958 and amended in 1967 emphasize that relatedness depends on the "facts and circumstances" in "each case." The need for a case-by-case factual approach was not altered by the 1969 amendment to section 513(c). Although Congress considered whether to enact a *per se* rule that journal advertising was unrelated, it did not do so, and instead left unchanged the "substantially related" standard of section 513(a) and the case-by-case factual approach of the regulations. The only action Congress took was to permit fragmentation of a "business" into multiple activities (e.g., treating advertising and editorial matter in a journal separately) so that each would be tested independently as to whether it "contributes importantly" to the organization's exempt purposes.

Since the 1969 Act did not change the definition of "substantially related," the 1969 legislative history concerning when advertising or other particular activities are "substantially related" under the 1950 act is of little value in applying section 513(a) in this case. The court of appeals properly found that history unpersuasive. It reveals not that Congress intended to tax all journal advertising or to endorse the government's reading of the regulations in this case, but rather merely to permit advertising and other activities to be treated separately. While such fragmentation might well result in advertising income being taxed in most cases, it still permits exemption based on the facts and circumstances in particular cases in which advertising activity is shown to contribute importantly to an exempt purpose or function of an organization. This is such a case.

The government's reliance upon Example 7 of the regulations as the source of a *per se* rule applicable in this case is misplaced. The substantive portion of the regulations does not purport to set forth any such rule. Example 7 concerns an organization whose exempt function is to promote industry objectives — a "mutual benefit" business league exempt under section 501(c)(6) rather than a "public service" charitable organization such as the College which the government stipulated to

be exempt under section 501(c)(3) — and such differences in function or purpose are material. Moreover, the stringently regulated, uniquely informative advertising for prescription drugs involved here is not akin to the "ordinary commercial advertising" in Example 7.

The court of appeals was not asked to and did not invalidate Example 7. Rather, it properly applied the regulations to the facts and circumstances established by the record in this case showing that the advertising in *Annals* contributes importantly to the College's exempt purposes. However, if Example 7 were construed as establishing a *per se* rule or conclusive presumption applicable in this case, it would be invalid as being contrary to the Code and inconsistent with the substantive provisions of the regulations. It should be applied no more broadly than the express limitations stated in the example to avoid raising questions of its validity, and the questions raised by application of Example 7 to business leagues or other organizations, however fascinating, should left for a case involving such an organization.

The government also argues that *Annals* competes with the publications of for-profit organizations. However, as the government has successfully established in other cases, the presence or absence of competition is irrelevant under the statute. The test is the relationship of the activity to the exempt functions of the organization.

Finally, there is no basis for the government's contention that the decision below sanctions unfair competition, imposes substantial costs, or requires a novel or burdensome case-by-case analysis. The statute and regulations have always required a case-by-case analysis of the facts and circumstances; few organizations are likely to be able to make such a strong showing that advertising in their journals contributes importantly to their exempt purposes; and there is no basis for apprehending unfair competition.

The government's theory is that the type of advertising, the nature of the exempt function, and proof of the ads' contribution thereto are essentially irrelevant. Such a test is not in the statute

or regulations and is not mandated by legislative history. The court of appeals properly rejected the government's theory and so should this Court.

ARGUMENT

I. Congress Did Not Enact or Endorse a *Per Se* Rule for Determining Whether Journal Advertising Has a "Substantial Relationship" to an Organization's Exempt Purpose.

The government, supported by *amicus* American Business Press ("ABP"), advocates in this Court a *per se* rule or conclusive presumption under which evidence that the advertising in *Annals* contributes importantly to the purposes underlying the College's exemption under section 501(c)(3) is irrelevant as a matter of law. It is easier to pick up mercury, however, than to grasp with certitude either the content or the source of the government's *per se* rule.

While this purported "rule" appears in many guises and is claimed to spring from many sources,[17] the government's favor-

17. For example, the government's statement of the question presented suggests a rule that "commercial advertising in the journal of a tax-exempt medical association" is unrelated business income (Gov't Br. i). Elsewhere, however, the government urges broader formulations to the effect that any income from commercial advertising in "publications of any tax-exempt organization" (*id.* at 15, 27, 29, 40 n.13, 41, 42, 43), or any income from "advertising" in such publications, is unrelated business income (*id.* at 9, 15, 25, 26, 28). At other times, it frames the rule more narrowly as applying only to "ordinary" commercial advertising (*id.* at 11), any "advertising business carried on by any exempt organization in competition with other taxpaying advertising business" (*id.* at 25), or "advertising 'designed and selected in the manner of ordinary commercial advertising' " (*id.* at 8, 10, 11, 18, 28, 30, 42).

As for the source of the rule, sometimes it is said to be rooted in the 1950 Revenue Act or its legislative history (*id.* at 11), while at other times the attributed provenance is either the 1967 Treasury regulations (*id.* at 8, 16-18, 27-28, 29, 32), the legislative history of the Tax Reform Act of 1969 (*id.* at 9, 18-26, 29, 32, 33), or a subsequent amendment to the regulations (*id.* at 4, 5, 26 n.7). Except for noting a cryptic reference to "advertising" in the heading of section 513(c) (Gov't Br. 4, 7, 9, 24), the government makes no effort to root its *per se* rule in the language of the Code itself, normally the prime evidence and embodiment of Congressional intent. The Code makes clear that heading references do not constitute substantive law. I.R.C. §7806(b).

ite formulation ("advertising 'designed and selected in the manner of ordinary commercial advertising' " is unrelated), is based on Example 7 of the 1967 regulations, although, significantly, it fails to embody all of the material factual elements of that example.[18] The government's difficulty in articulating and documenting precisely the *per se* rule it advocates reflects the rule's doubtful legitimacy. *Per se* rules or conclusive presumptions barring consideration of relevant evidence are disfavored, and will not ordinarily be inferred.[19] Here, examination of the statute, regulations, and pertinent legislative history demonstrates that the government's *per se* rule, in any of its manifestations, is simply untenable.

A. The 1950 Revenue Act did not tax income from advertising in professional journals.

The unrelated business income tax ("UBIT") was first enacted in the Revenue Act of 1950, ch. 994, § 301, 64 Stat. 906, 947, in response to widespread negative publicity over acquisitions of clearly unrelated businesses by exempt organizations in the 1940's. A prime example involved the transfer of the income of the Mueller macaroni company to New York University School of Law. *See C. F. Mueller Co. v. Commissioner*, 190 F.2d

18. It omits in particular the reference to an organization exempt under section 501(c)(6), to which alone Example 7 refers, and the requirement that the informational function of the ad be "incidental" and "differ in no essential respect from the informational function of any commercial advertising" (see pp. 19-20, 42, *infra*).

19. A regulation establishing a conclusive presumption should be even more vulnerable than a statute, as to which this Court has said: "Statutes creating permanent irrebuttable presumptions have long been disfavored under the Due Process Clauses of the Fifth and Fourteenth Amendments." *Vlandis v. Kline*, 412 U.S. 441, 446 (1973) (citing, *e.g.*, *Heiner v. Donnan*, 285 U.S. 312 (1932) (invalidating conclusive presumption in tax law). The rationale for such disfavor is that, when a statute provides that a person's rights or privileges are governed by the existence of specified factual circumstances, a conclusive presumption concerning the operative determinations contrary to fact, and preclusion of factual determinations contrary to the presumption, constitutes a denial of due process. *See, e.g., United States Dep't of Agriculture v. Murry*, 413 U.S. 508, 514 (1973).

120 (3d Cir. 1951). Under then-existing law, because the destination of the income was a tax-exempt organization, the company's income achieved tax-exempt status, even though the purchase was financed in part by a loan to be repaid by future profits and the source of the income was wholly unrelated to the university's exempt purposes.

In a message to Congress, President Truman proposed changes to the tax laws to address "the conduct of business and industrial operations *entirely unrelated* to educational activities." *Hearings on Revenue Revision of 1950 before the House Comm. on Ways and Means*, 81st Cong., 2d Sess. 4-5 (1950) (emphasis added). Similarly, then-Secretary of Treasury Snyder testified concerning what was to become section 513(a):

> Business operations of charitable and educational institutions *clearly unrelated* to their exempt functions generally would be subjected to the regular corporation income tax. This would apply to organizations now engaging in such unrelated business activities as the manufacture of food products, leather goods, vegetable oils, and the distribution of petroleum products.

Hearings on Revenue Revision of 1950 before the Senate Finance Comm., 81st Cong., 2d Sess. 6-7 (1950) (emphasis added). He noted that the bill would not tax income "from related activities, such as the operation of bookstores, dining halls, dormitories, or experimental farms, *customarily carried on* by educational and charitable organizations." *Id.* (emphasis added).[20]

This legislative history speaks of closing a perceived loophole which permitted tax-exempt institutions to acquire totally unrelated private businesses and imbue them with tax-exempt status. The examples cited involved businesses having virtually nothing to do with the organizations' exempt purposes.

In response, Congress enacted the UBIT, now set forth in sections 511 to 514 of the Code. Section 511(a) imposed a tax on an exempt organization's "unrelated business taxable income," defined by section 512(a)(1) as the gross income derived by any

20. *See also* S. Rep. No. 2375, 81st Cong., 2d Sess., 28-31 (1950).

organization (less allowable deductions) from (1) any "trade or business," (2) "regularly carried on" by it, (3) that is "unrelated." Of these three statutory elements, the "related" test in issue here[21] has been described as "the most difficult to apply," one that "necessarily examines both the content of an institution's exempt function . . . and the relationship of the activity in question to that exempt function." Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 Colum. L. Rev. 1430, 1450 (1980).[22]

Section 513(a), which since its enactment has not been amended, defines "unrelated" trade or business as including

> any trade or business the conduct of which is not *substantially related* (aside from the need of such organization for income or funds or the use it makes of the profits derived) *to the exercise or performance* by such organization of its charitable, educational, or other *purpose or function constituting the basis for its exemption* under section 501. [Emphasis added].

Despite references in the legislative history to unfair competition, this statutory scheme makes no reference to competition; by its terms, income from an "unrelated" trade or business is taxable even if there is no competition, while income from a "substantially related" trade or business is exempt no matter how intense or "unfair" the competition. *Louisiana Credit Union League v. United States*, 693 F.2d 525, 541-42 (5th Cir. 1982). The key is the "relatedness" of the trade or business to the organization's exempt purpose. Nothing in the language of the

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21. The College does not contest that its publication of advertising in *Annals* in 1975 was a "trade or business" as defined in section 513 or was "regularly carried on." Solely the "relatedness" of the advertising activity is at issue in this case.

22. *See also* Rose-Ackerman, *Unfair Competition & Corporate Income Taxation*, 34 Stan. L. Rev. 1017, 1018 (1982) ("Of course, the meaning of 'related' is not obvious and [IRS] and the courts have experienced predictable difficulties settling on a definition."); P. Treusch & N. Sugarman, *Tax Exempt Charitable Organizations*, 186-87 (1979).

statute or its history even remotely suggests that Congress intended that income from advertising in professional journals — which in 1950 was a well-established activity "customarily carried on" by exempt organizations[23] — was to be deemed unrelated and taxed generally or at all. Indeed, for the next 17 years the IRS did not seriously attempt to tax journal advertising income, and the College, like other exempt organizations, did not pay taxes on it. As the court stated in *ACP I*, "[t]he 1950 Act was a fairly limited measure, designed to distinguish the customary activities of exempt organizations from the operation of independent business enterprises entirely unrelated to the educational purpose of the organization." 530 F.2d at 933; *see also Massachusetts Medical Society v. United States*, *supra*, 514 F.2d at 155. There is simply no merit to any suggestion that the 1950 Act or its history supports any formulation of the government's *per se* rule.

B. The Treasury's interpretative regulations require analysis of the facts and circumstances of each case and do not purport to set forth any *per se* rule concerning journal advertising of organizations exempt under section 501(c)(3).

The first regulations to interpret sections 511 through 514 appeared in 1958 and made no attempt to tax journal advertising. The original regulations made clear that the analysis to be undertaken in determining whether there was a "substantial relationship" was factual, and that the decision whether or not the activity was taxable depended upon the "particular circumstances involved in each individual case." Treas. Reg. §1.513-1(a)(2) (1958).

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23. *ACP I*, 530 F.2d at 933. The College, for example, has included advertising in its journal since at least 1927. *E.g.*, 1 *Annals Of Internal Medicine* No. 2 (1927). References in unenacted bills in a prior Congress to unrelated publishing activities (ABP Br. 9-10) in no way indicate that Congress intended the 1950 Act to tax journal advertising.

In 1967, the Treasury published revised interpretive regulations which took steps to address the argument that "commercial advertisements arguably were part and parcel of a unified trade or business ('publishing') with an ultimately educational end" (Gov't Br. 13). These regulations for the first time "fragmented" the activities of a tax-exempt organization into individual components, stating that for purposes of ascertaining whether income was derived from a "trade or business," activities do not lose their identity because carried on within a larger complex of the organization's other endeavors. 32 Fed. Reg. 5993 (1967); *see* Treas. Reg. § 1.513-1(b). With particular respect to advertising, the regulations provide that "activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to the exempt purposes of the organization." *Id.*

The regulations additionally define an activity "substantially related" to an organization's exempt purposes as one which "contribute[s] importantly to the accomplishment of those purposes." 32 Fed. Reg. 5994 (1967); *see* Treas. Reg. § 1.513-1(d)(2). They reiterate that

> [w]hether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in *each case* upon the *facts and circumstances* involved. [*Id.* (emphasis added).]

Following the foregoing "applicable principles" in the regulations, there appear several illustrative "examples." 32 Fed. Reg. 5995 (1967); *see* Treas. Reg. § 1.513-1(d)(4)(iv). Example 5 addresses advertising in publications of universities (typically exempt pursuant to section 501(c)(3)) and presents circumstances in which advertising income is deemed "substantially related to the university's exempt aims" and thus exempt from tax. *Id.* Example 6, as proposed, purported to apply to "Z," "an exempt trade organization" which published a monthly journal and received

income from publication therein of "general consumer advertising, including advertising of such products as soft drinks, automobiles, articles of apparel, and home appliances." The income received from this advertising was deemed to be taxable. *Id.*

Although neither the applicable principles nor the examples in the proposed regulations purported to set forth any general or *per se* rule relating to advertising, the IRS Technical Information Release which accompanied the proposed regulations indicated that, as a general rule, IRS did intend to consider advertising as unrelated activity. Technical Information Release No. 899, April 14, 1967, I.R.B. 1967-19, 43, ("TIR-899"), reprinted in 1967-7 Stand. Fed. Tax Rep. (CCH) ¶ 6557. Consequently, as the government acknowledges (Gov't Br. 16), the proposed regulations unleashed a storm of controversy concerning both the new fragmentation principle and the possibility that they might portend *per se* treatment by IRS of all advertising income.

Following the comment period, in the final regulations Treasury made no pertinent changes to the applicable principles, but did significantly change the examples. It revised Example 6 by replacing the general reference to "an exempt trade organization" with the narrower specific reference to "an association exempt under Section 501(c)(6), formed to advance the interests of a particular profession and drawing its membership from the members of that profession." Treas. Reg. § 1.513-1(d)(4) Example 6.

For the first time, Treasury also added Example 7, the major source of the government's espoused *per se* rule in this case. Example 7 adopts the facts of Example 6 as to the nature of "Z," but restricts the advertising in "Z's" journal to "products which are within the general area of professional interest of its members," which conform to "certain general standards of taste, fairness, and accuracy," and which are "designed and selected in the manner of ordinary commercial advertising." Example 7 further assumes that the informational content of the ads is "incidental to the controlling aim of stimulating demand for the advertised products." The example concludes that the advertising so described does not contribute importantly to the accomplishment of the (c)(6) organization's exempt purposes. Treas.

Reg. § 1.513-1(d)(4) Example 7. Although the government implies otherwise (Govt. Br. 8), Example 7 makes no reference to medical journals or prescription drug ads. The regulations were published in this changed and narrowed form in December, 1967 (32 Fed. Reg. 17,657), unaccompanied by any repetition of the broad statement that had accompanied the earlier proposal, a fact overlooked by the government in its reliance upon TIR-699 (Govt. Br. 15, 36).

The examples in the 1967 regulations have been criticized for being conclusory and providing little guidance.[24] Nevertheless, even with the narrowing of Examples 6 and 7 to (c)(6) organizations, the regulations have a major impact, for some of the magazines accounting for the largest volume of advertising revenue are published by (c)(6) organizations, such as *Nation's Business* (published by the Chamber of Commerce), while many of the publications of (c)(3) organizations containing a large volume of advertising do not readily satisfy the "contributes importantly" standard (*e.g.*, *National Geographic*). "The regulations, however, also recognize that in some limited cases income from advertising may be regarded as 'related' when found to 'contribute importantly' to the accomplishment of the exempt purpose." P. Treusch & N. Sugarman, *Tax Exempt Charitable Organizations*, 196 (1979).

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24. *See*, *e.g.*, Kaplan, *supra*, 80 Colum. L. Rev. at 1453 ("No precise guideline is given for determining when the activity's contributions have risen to the level of importance required, and probably none is possible. Consequently, the examples provided are often more conclusory than analytical."); *id.* at 1454 ("Of less help in understanding the application of the 'contributes importantly' standard are the illustrations that focus on an activity's content").

C. The Tax Reform Act of 1969 placed in the tax laws only the fragmentation principle of the 1967 regulations.

1. Introduction: the UBIT amendment had limited significance among the many larger issues addressed in the 1969 Act.

The controversy did not subside after publication of the 1967 regulations, particularly as to the "fragmentation" of a journal into editorial matter and advertising. The debate continued not only in academic commentary such as that cited by the government, but in Congress, resulting in amendment of section 513(c) of the Code in the Tax Reform Act of 1969. Unfortunately, the government's description of the legislative debate is seriously flawed, omitting, for example, any mention of the important conference report and the language of the Senate-passed bill, which differed significantly from the legislation enacted.

In assessing the history of the 1969 legislation, several points must be noted at the outset. One is that the bill was complex and long (H.R. 13270 was 368 pages), the amendment to section 513(c) was a relatively minor issue,[25] and the subjects covered by the bill were addressed in wide-ranging House and Senate hearings (totalling more than 12,000 pages) and lengthy committee reports (totalling more than 1000 pages). Not surprisingly in such a situation, different and at times contradictory items can be found buried in the massive legislative history, and courts must be particularly cautious in attributing to Congress an intent not firmly rooted in the statutory language.

Furthermore, the hearings before the House Ways and Means Committee which the government repeatedly cites preceded introduction of the House bill. They addressed no bill but merely a variety of broadly framed issues.[26] The issue pertinent

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25. The amendment of section 513(c) was not among the Ways & Means Committee's summary of the "principal provisions" of the bill concerning tax-exempt organizations. House Comm. on Ways & Means, 91st Cong., 1st Sess., *Revised Summary List and Brief Description of Provisions Contained in H.R. 13270*, 1 (Comm. print 1969).

26. Before the House bill was introduced, legislative proposals had run the gamut from wholesale deferral or rejection of the 1967 regulations to their

to the treatment of advertising was framed by the Committee at the outset as follows:

> whether advertising income should be characterized as unrelated in the case of magazines and other periodicals published by exempt organizations where the editorial matter of the publication is related to its exempt function.

Hearings on Tax Reform, 1969, before the House Comm. on Ways & Means, 91st Cong., 1st Sess. 6 (1969).[27] Had Congress adopted legislation embodying an affirmative answer to that question, there might be some basis for the government's claimed *per se* rule. It is evident from its language and history, however, that the legislation finally enacted in 1969 stopped far short of an unqualified affirmative answer to that question. In effect, Congress decided only to let advertising activity stand on its own two feet.

2. The statutory language ignored by the government does not support a *per se* theory

At the conclusion of the House hearings, Representative Mills, Chairman of the House Ways & Means Committee, introduced H.R. 13270, which was reported to the House the next day. The bill made no reference to the regulations, to what is "related," nor to any *per se* rule concerning advertising. Rather, it merely amended section 513(c) to provide that, for the purposes of section 513,

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NOTES *(Continued)*

wholesale endorsement, with a myriad of variations along the way. Legislative history involving unenacted bills in a prior Congress (*see* Govt. Br. 18-19, 36-37; ABP Br. 15-19) sheds no light on the question before the Court in this case (see p. 30 n.37 *infra*).

27. The issues raised by the regulations were of such marginal consequence in the larger context that, even after this question was posed by the Committee, the advertising issue was not on the list of amendments the Administration was seeking with respect to UBIT. *See, e.g., House Hearings*, pt. 14, at 5047-49, 5131-45, 5481-82, 5491, 5500, 5509.

> the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

H.R. 13270, 91st Cong., 1st Sess., § 121 (1969).

Thus, the bill merely incorporated the fragmentation principle set forth in the 1967 regulations to permit separate consideration of the relatedness of a journal's editorial and advertising activities (Treas. Reg. § 1.513-1(b)), and thus to permit but not require taxation of journal advertising. As the House Report explained:

> Therefore, for example, the advertising contained in a publication of an exempt organization *may* be subject to the tax under section 511 even though the editorial content of the publication may be related to the exempt purposes of the organization.

H.R. Rep. No. 413, 91st Cong., 1st Sess. , pt. 2, at 26 (1969) (emphasis added).

The proposed amendment met opposition in the Senate. After further extensive hearings reflecting a welter of views, the Senate Finance Committee reported out a version of the House bill containing a materially different version of the amendment to section 513(c). Criticizing the existing statutory basis for the regulations as being "sufficiently unclear that substantial litigation could result from [the 1967] regulations," the Committee believed that in some sense the regulations "should be placed in the tax laws." S. Rep. No. 552, 91st Cong., 1st Sess., 75 (1969).[28]

28. The government seizes on this loose and not entirely accurate generalization as endorsement of its purported *per se* rule (e.g. Govt. Br. 9, 26, 27, 33). Of course, the sole portion of the regulations eventually "placed in the tax laws" was fragmentation. See p. 25 *infra*.

However, the Committee amendment (which the Senate adopted) differed from the House bill and the regulations in that it expressly declared only that advertising, pharmacies and horse races each constituted separate activities of an exempt organization.[29]

While more specific, this Senate-passed bill too addressed only the propriety of the fragmentation of activities; neither bill addressed whether or when a trade or business was "substantially related" within the meaning of section 513(a), a provision which was not amended in any respect by either bill.

The conferees did not entirely endorse either bill. They returned to the broader statement of fragmentation in the House bill, omitted the specific references to advertising, pharmacies, and horse racing in the Senate bill, and included fragmentation language common to both. The Conference Report, normally the most definitive commentary on legislation, provides no support for the government's position, referring only to the language of the bills concerning fragmentation and making no reference to the regulations, to any *per se* rule concerning what is "substantially related," nor to any other application of the fragmentation principle to advertising or to any other particular trade or business activity. H.R. Rep. No. 782, 91st Cong., 1st Sess., 292 (1969).

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29. As passed by the Senate, H.R. 13270 provided that, for purposes of section 513,

> the term 'trade or business' includes the following activities carried on for the production of income:
>
> (1) the publication of advertising in any magazine, newspaper, periodical, or other publication, or the dissemination of advertising by radio or television broadcasts,
>
> (2) the conduct of a pharmacy, and
>
> (3) the conduct of horse races.
>
> For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

In a case involving the application of the "relatedness" test to income from a hospital pharmacy, one of the activities targeted with advertising for fragmentation in the Senate bill, the Fifth Circuit, after consideration of all of the pertinent legislative history, aptly described the final bill as rejecting the Senate bill's "mechanical" approach to fragmentation for the "more general approach" of the House bill, under which the issue of relatedness was still a "remaining question" not resolved by the legislation. *Hi-Plains Hospital v. United States*, 670 F.2d 528, 532 (5th Cir. 1982) (*see* p. ____*infra*).

Despite the heated debate described in the briefs of the government and ABP, therefore, the plain fact is that Congress did not, as it easily might have, enact *per se* taxation of journal advertising. Instead, it unambiguously codified only the principle that an exempt organization's business activities could be fragmented into their separate components, each of which must be tested and taxed according to the standard of section 513(a). "[T]he statute does not pretend to say whether or when [advertising] is 'unrelated' to the organization's exempt function." Treusch & Sugarman, *supra*, at 196.

Finding no support in the statutory language,[30] the government is forced to try to divine a Congressional intent in the tea leaves of legislative history. When the terms of a statute are unambiguous, however, they are conclusive, and legislative history need not be resorted to except in rare and exceptional circumstances. *United States v. Clark*, 454 U.S. 555, 560 (1982); *Howe v. Smith*, 452 U.S. 473, 483 (1981). *See also Louisiana Credit Union League v. United States*, *supra*, 693 F.2d at 541. The plain words of section 513 do not permit or require such resort here.

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30. The government inaccurately describes the 1969 amendment as "expressly sanctioning 'fragmentation' of an activity into exempt purpose and unrelated business components" (Govt. Br. 24). Under the amendment, each of the fragmented activities or components could still be shown to be "related." Since the government's *per se* rule cannot be founded in the language of the statute, the only other potentially proper source for it is the regulations. As we demonstrate below, however, the regulations also cannot properly be read as establishing such a rule (*see* pp. 33-46, *infra*).

3. The committee reports relied on by the government do not endorse a *per se* theory governing this case

The government's case is bottomed upon wholesale "legislation by committee report." At the heart of its argument are the statements in the House report that the regulations mainly affected medical journal advertising, and that "Your Committee . . . has concluded that advertising in a journal published by an exempt organization is not related to the organization's exempt functions." H.R. Rep. No. 413, *supra*, pt. 1, at 50. However, those statements were not reiterated in the Senate report, the Conference report, nor, more importantly, in the legislation enacted.

Moreover, this statement in the House report relating to the application of the regulations to the "substantially related" element of section 513(a) — more broadly framed than even Example 7 of the regulations (to which no report referred) — cannot properly be viewed as any more than an indication that, *in general*, exempt organizations would not readily be able to demonstrate that the advertising in their journals contributes importantly to their exempt purposes.[31] If the Committee also expressed overall agreement with the regulations, it necessarily endorsed the governing principle that whether *any* trade or business contributes importantly will depend upon the "facts and circumstances" of "each case." It is not plausible that, having endorsed that principle, the Committee was purporting to make a categorical factual determination applicable in all cases which would bind IRS and the courts in applying the regulations and section 513 as amended.

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31. The government errs in reading the House report as endorsing the regulations *in toto* and as categorically determining how they apply to advertising income from publications. The pertinent discussion relied on by the government is introduced by "In general," and further states that "it is anticipated" that advertising income will constitute unrelated business income (H.R. Rep. No. 413, *supra*, pt. 1, at 50). Reference to the "anticipated" result of applying the facts and circumstances test "in general" to advertising is not consistent with mandating a *per se* rule requiring that result.

In other respects, the committee reports reflect little more than approval of the regulations in a *general* sense, not necessarily all of their particular provisions. As the court of appeals aptly noted, "[t]he legislative history addresses advertising generally and does not grapple with specific factual situations" (Pet. App. 13a).

4. The statements in hearings relied on by the government provide no reliable evidence of Congressional intent

The other principal category of legislative history relied upon as authority for the government's *per se* rule consists of scattered statements made in the voluminous House committee hearings, mostly by opponents of the 1967 regulations before there was any specific bill to address (Gov't Br. 19-22; *see* ABP Br. 19-24).[32] However, "[r]emarks of this kind made in the course of legislative debate or hearings other than by persons responsible for the preparation or the drafting of a bill, are entitled to little weight. . . . This is especially so with regard to the statements of legislative opponents who '[i]n their zeal to defeat a bill . . . understandably tend to overstate its reach.'" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203-04 n.24 (1976) (citations omitted).

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32. The government and ABP stress certain testimony in the House hearings by then-Executive Director of the College, Dr. Rosenow, concerning the 1967 regulations. In addition to explaining how the advertising in *Annals* was in fact "substantially related" to the College's exempt purposes, Dr. Rosenow — a physician and not a tax lawyer — expressed his concern that the regulations might be deemed to have the effect of conclusively presuming that advertising income from the College's publication was taxable. *House Hearings* 1113-14. Agencies and other litigants frequently, after further consideration, ultimately take a position different from their initial stance concerning the proper interpretation of a law or regulation. *See, e.g., Automobile Club v. Commissioner*, 353 U.S. 180 (1957) (Court sustained IRS' retroactive reversal of position concerning interpretation of law governing exempt status). Familiar with often hyperbolic advocacy presentations, Congress could not be expected to base its understanding of the regulations on the characterization by opponents of them.

The government and ABP point out that the hearings on the 1969 legislation, like the history of the 1950 Act, contain references to "unfair competition" (Gov. Br. 23; ABP Br. 4-6, 22-25). As Professor Bittker has noted, however, the legislative history of the UBIT reveals no analysis of such assertions of "unfair competition," which he terms "overstated if not wholly erroneous." B. Bittker & G. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 Yale L.J. 299, 319 (1976).[33] Moreover, as the court noted in *Louisiana Credit Union League v. United States*, *supra*, in interpreting the definition of a "trade or business" in section 513, "[a]lthough the legislative history speaks of competition, those who actually drafted the statute avoided the word as if it were the plague." 693 F.2d at 541. The UBIT "lacks a consistent economic underpinning. Rather it is a political compromise . . ." Kaplan, *supra*, 80 Colum. L. Rev. at 1466, 1471. In short, the vaguely expressed concerns about competition provide no statutory basis for determining whether in a particular case a trade or business is "substantially related" to an organization's exempt purposes.

The hearings reflected a variety of points of view concerning whether advertising in particular publications might be deemed to "contribute importantly" to the purposes underlying the exemptions of particular organizations. By giving general endorsement to the regulations, which mandate that the issue turns on the "facts and circumstances" of "each case," Congress wisely left

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33. In fact, one commentator recently concluded (a) that "nonprofits are no more likely to engage in predatory pricing than for-profits," (b) that it is problematic whether or to what extent there is any other problem of unfair competition, and (c) "that the present tax on nonprofits' 'unrelated' business income is exactly the wrong way to deal with the problem, generating more 'unfairness' than it has prevented. While an economically sophisticated definition of unfairness is possible, its application involves subtle empirical issues — so subtle that they may be beyond the administrative capacities of the IRS. As a consequence, outright repeal of the tax on unrelated business activities seems like the best policy response." Rose-Ackerman, *supra*, 34 Stan. L. Rev. at 1021-22, 1039.

resolution of those conflicting contentions to the application of the Code and the regulations in particular cases.

* * *

In sum, although the government repeatedly describes Congress as having "validated" the regulations and "placed them in the tax laws" (Gov't Br. 9, 25, 27), the only issue of validity identified by Congress was fragmentation, and that was the sole aspect of the regulations so "placed." In all other pertinent respects, the 1950 legislation and the regulations were unaffected by the 1969 Act. The government points only to Congressional statements in 1969 about how the provisions of section 513(a), enacted in 1950, should be construed, but such statements are entitled to no weight. "It is the intent of the Congress that enacted [the section] . . . that controls." *Oscar Mayer & Co. v. Evans*, 441 U.S. 750, 758 (1979) (citations omitted). The most that the legislative history suggests is that Congress intended as a *general* matter to endorse the principles incorporated in the 1967 regulations, primary among which was the "facts and circumstances" test. Congress did not analyze and endorse each and every word, and certainly not any particular applications of any illustrative example.[34]

In interpreting the intent of Congress in fashioning a compromise legislative solution, "the wisest course is to adhere closely to what Congress has written." *Rodriguez v. Compass Shipping Co.*, 451 U.S. 596, 617 (1981); *see also Mohasco Corp. v. Silver*, 447 U.S. 807, 826 (1980). If the Court's construction of Congress' intent "clashes with present legislative expectations, there is a simple remedy — the insertion of a brief appropriate phrase, by amendment, into the present language of §[513]. But it is for Congress, and not this Court, to enact the words that will

34. *See* Nomberg, IRS Tax Management Memorandum 76-12, p. 7 (June 7, 1976) ("The question of which advertising, if any, is related may be a fertile area for future litigation"); Liles & Blum, *Development of the Federal Tax Treatment of Charities*, 39 Law & Contemp. Probs. 6, 33 (Autumn 1975) (amendment "[left] unaffected the definition of 'unrelated'. Thus, exempt organizations can still argue . . . that certain kinds of advertising . . . are 'related' to the organization's exempt purposes").

produce the result the Government seeks in this case." *Bifulco v. United States*, 447 U.S. 381, 401 (1980).[35]

D. The 1971 amendment to the regulations provides no support for the government's per se rule.

As support for its *per se* rule, the government repeatedly cites section 1.512(a)-1(f) of the regulations, which contains a broad statement that, under section 513 of the Code and section 1.513-1 of the regulations, "*[i]n general* . . . amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business" (Gov't Br. 4, 5, 26 n.7) (emphasis added). That provision, promulgated in 1971, obviously cannot be said to have been endorsed by Congress in the 1969 Act. Moreover, the statement by its terms is a loosely phrased generalization introducing the subject matter of that section — the allocation of income and expenses between advertising and editorial content in cases where one is taxable and the other is not. Indeed, in its unqualified breadth, the statement is inconsistent with section 513(a) (e.g., activities for the convenience of members)[36] and the cited regulations (*e.g.*, Example 5). In short, this superfluous introductory language cannot be the basis for a *per se* rule if, as is the case, such a rule cannot be grounded in the 1967 regulations or the 1969 amendments.[37]

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35. Curiously, in view of the claimed significance of the decision below, the government did not include amendment of UBIT among the Administration's extensive recommmendations for revisions of the tax laws. *The President's Tax Proposals to the Congress for Fairness, Growth & Simplicity, May 29, 1985 (1985)*.

36. *See* p. 40 n.47 *infra*.

37. Forced to seek post-enactment evidence of the intent of Congress in the 1969 amendments, ABP notes that in several later Congresses bills concerning advertising income were introduced but that the bills were neither enacted nor the subject of hearings (ABP Br. 6). Unenacted bills, however, have no value as evidence of Congressional intent. *E.g., Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381-82 n.11 (1969); *FTC v. Dean Foods Co.*, 384 U.S. 597, 609-10 (1966). This is particularly so here, where the later bill would only have amended section 512 to modify the computation of taxable income from unrelated advertising. *E.g.*, H.R. 990, 96th Cong., 1st Sess. § 8 (1979).

II. The Court of Appeals Properly Looked to the Facts and Circumstances Rather than Apply a Per Se Rule.

Despite the government's insistence here upon a *per se* rule, this case was litigated and decided throughout, in accordance with *ACP I*,[38] as requiring a factual inquiry based on an evidentiary record and an analysis of the relationship between the specialized drug advertising in *Annals* and the College's exempt section 501(c)(3) purposes. Inconsistently with its *per se* approach in this Court, the government neither moved for summary judgment nor objected at trial to the relevance of the College's uncontradicted evidence of the importance of the contribution of the advertising in *Annals* to its exempt purposes. Both courts below applied a factual analysis, not a *per se* approach. The Claims Court's factual analysis was overly restrictive, but nevertheless posited instances in which with slight variations in the facts the College's advertising activity could be deemed substantially related. The government itself on appeal took the position that "the Statute and Regulations require a factual inquiry into the activity, and its relationship to exempt functions," and, citing *ACP I*, that it "cannot be doubted that the question involved here is one of fact" (Brief for Appellee, pp. 3, 8-9).

The court of appeals was correct in agreeing with both parties and the trial court that the issue to be resolved was factual. *Accord*, *Hi-Plains Hospital v. United States*, *supra*, 670 F.2d at 531; *Professional Insurance Agents v. Commissioner*, 726 F.2d 1097, 1130 (6th Cir. 1984). Its refusal to overemphasize the commercial aspects of the College's advertising is equally consistent with prior authority. In *Hi-Plains Hospital*, *supra*, the Fifth Circuit determined that a hospital's revenues from the sale of drugs from its pharmacy directly to member physicians' private patients were exempt as substantially related to efforts by the hospital to attract and keep physicians in the region. The

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38. *See* 4 J. Rabkin & M. Johnson, *Federal Income, Gift & Estate Taxation* ¶ 59.02A(4), at 5919h (1982) (*ACP I*, "while involving only pre-1970 years, indicates that its holding might nevertheless apply for later years").

commercial character of the sales, as well as the inherent competition with "commercial" pharmacies, did not detract from the court's appropriate focus on the furtherance of the rural hospital's exempt goal of providing high-quality medical care to the community by attracting competent physicians.[39] Although the 1969 Senate bill had specifically enumerated sales from hospital pharmacies, together with advertising, in its categorical list of activities to be fragmented (*see* p. 24 & n.29, *supra*), the court's inquiry paralleled the analysis of the court of appeals in this case:

> While the rejection of the Senate version does not imply that sales by a hospital pharmacy to the general public were not within the ambit of section 513, it does indicate that the Congress rejected a mechanical application of section 513 to such sales in favor of a more general approach. Moreover, the purpose of this amendment was to identify particular activities as a trade or business within the meaning of section 513. *Such identification does not answer the remaining question of whether that activity is substantially related to the exempt purpose of the charitable organization*. [670 F.2d at 332 (emphasis added).]

The Fifth Circuit's factual analysis and its appraisal of the same legislative history pertinent to this case confirms the correctness

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39. Other rulings also disapprove of the use of commerciality or competition as the determinative factor in analyzing the "relatedness" of an activity. For example, Rev. Rul. 73-104, 1973-1 C.B. 263, holds that the sale of greeting card reproductions of works of art by a museum, at competitive prices, is tax-exempt. *See also* Rev. Rul. 69-267, 1969-1 C.B. 160 (income from sale of items in hospital gift shop exempt). The presence or absence of competitive aspects has certainly not been the determinative factor outside of the area of advertising. *See, e.g., Clarence LaBelle Post No. 217 v. United States*, 580 F.2d 270 (8th Cir.), *cert. dismissed*, 439 U.S. 1040 (1978) (bingo revenues held taxable even though there could be no commercial competition); Rev. Rul. 80-295, 80-296, 1980-2 C.B. 194, 195 (revenues from broadcast of intercollegiate athletics exempt).

of the decision of the court of appeals below.[40]

III. The Court of Appeals Did Not Invalidate Example 7 of the Regulations.

The government to the contrary, the court of appeals did not invalidate any portion of the regulations, implicitly or otherwise. Example 7 of the regulations does not establish a broad *per se* rule applicable to organizations exempt under section 501(c)(3) and, in any event, the record does not support the application of Example 7 to this case. If it were to be construed as a *per se* rule governing this case, Example 7 would be invalid as irrational and in conflict with the statute and regulations. As a prudential matter, therefore, this Court should construe the regulation so as to avoid raising questions concerning its validity.

A. Example 7 does not establish a broad per se rule

The government's favorite formulation of its espoused *per se* rule that all advertising income is taxable is based on Example 7 of the regulations. The government suggests that Example 7 establishes a "conclusive presumption" to the effect that, regardless of the category of organization or the nature of the product or service, advertising in a professional journal of an exempt organization cannot contribute importantly to the purposes underlying the organization's exemption. The government attacks the court of appeals' decision, which did not expressly address Example 7, as "invalidat[ing] sub silentio" a regulation explicitly endorsed by Congress (Gov't Br. 27-28). As discussed above, however, the sketchy and generalized legislative history and the eventual enactment of section 513(c) do not support a conclusion that Congress endorsed Example 7 as construed here by the government. The court of appeals' silence on Example 7 is more

40. Application of the "facts and circumstances" test is well illustrated by contrasting the result in *Hi-Plains Hospital* with that in *Carle Foundation v. United States*, 611 F.2d 1192 (7th Cir. 1979), *cert. denied*, 449 U.S. 824 (1980). In the former case, the operation of a pharmacy by a (c)(3) hospital was found to contribute importantly and in the latter, where no evidence was presented as to the pharmacy's role in inducing physicians to staff the hospital, it was not.

easily explainable as reflecting its agreement with the College that Example 7 was not applicable to the College and so not controlling in this case.

To urge a *per se* rule based on Example 7, the government must ignore the patent inconsistency of such a rule with the basic principles espoused in the regulations and even with the other examples that illustrate those principles. The regulations contain generally "applicable principles" setting forth the rules for determining when income of an exempt organization is unrelated, including the principle that "each case" is to be determined on the basis of all the "facts and circumstances." Treas. Reg. § 1.513-1(d)(2). Example 7 is simply what its name states, one of seven "examples" of the case-by-case application required by the Code and regulations. A *per se* rule would normally be found in a discussion of "principles" rather than "examples," and the "examples" cannot be described as setting forth "rules" applying beyond their own particular facts. When an agency's interpretation or application of its own rules flies in the face of the language of the rules themselves, it cannot be accepted. *Shea v. Vialpando*, 416 U.S. 251, 262 n. 11 (1974); *Union of Concerned Scientists v. NRC*, 711 F.2d 370, 381 (D.C. Cir. 1983).

One result of the government's efforts to elevate Example 7 to a *per se* rule is its resulting necessity to recognize "exceptions" to that "rule" in order to accommodate other IRS rulings or examples in the regulations. The "chief" such exception is said to concern ads in a student-run newspaper at a college exempt under section 501(c)(3), addressed in Example 5 of the regulations (Gov't Br. 28-29 & n.10).[41] The government also acknowledges

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41. In attempting to belittle the pertinence of Example 5, the government asserts that the College regards Example 5 "as standing for the general proposition that advertising published by Section 501(c)(3) groups, as contrasted with advertising published by Section 501(c)(6) groups, is substantially related to educational purposes;" on this premise the government attributes to the College a theory under which "a Section 501(c)(3) group's *radio* advertising profits (Example 4) are taxable, while its *print* advertising profits (Example 7 supposedly being inapplicable) are not" (Gov't Br. 40 n.13). Neither contention is accurate. The College cites Example 5 as indicating merely that advertising

an exception, recognized by the IRS after the 1969 Act, for an ad in a publication of an organization exempt under section 501(c)(3) that contains no "message" but merely a list of corporate patrons (*id.*, citing Rev. Rul. 76-93, 1976-1 C.B. 1970, in which the IRS itself rejected a "conclusive" presumption approach and took into account the particular exempt nature of the organization).

This equivocation reflects the shakiness of the foundation upon which the government's *per se* rule is built. It is difficult to see any rational basis for treating an ad devoid of informational content as "contribut[ing] importantly" to the exempt purposes of a section 501(c)(3) organization, and yet to presume conclusively that uniquely informative ads, which indisputably provide an important contribution to those purposes as a factual matter, do not "contribute importantly" within the meaning of the regulations. Only in Alice's Wonderland might such results be justified.

B. Example 7 addresses only business leagues exempt under section 501(c)(6) and is not at issue in the present case.

By its own terms, Example 7 does not pertain to an organization like the College, exempt under section 501(c)(3). It purports to be limited to business leagues exempt under section 501(c)(6).

Organizations granted exemption by the IRS pursuant to section 501(c)(6) are business leagues, chambers of commerce, or similar organizations formed to advance the financial interests of the particular businesses from which their memberships are drawn (see p. 8 n.14 *supra*). "Trade associations are the most common instances of exempt 'business leagues,' along with professional groups like the American Bar Association and the American Medical Association." B. Bittker & G. Rahdert, *supra*,

published by a section 501(c)(3) organization *can* be found to contribute importantly and be substantially related to its exempt purposes under the applicable principles established in the regulations. Whether it does so in a particular case depends upon the relationship of the advertising (either its content or the process of obtaining and publishing it) to the exempt functions of the particular organization.

85 Yale L.J. at 355. The College, on the other hand, was stipulated to be exempt pursuant to section 501(c)(3) as a charitable, scientific, and educational organization.

The government argues nevertheless that Example 7 establishes a *per se* rule applicable to (c)(3) organizations. This argument can succeed only if the Treasury's deliberate narrowing of the reference to (c)(6) organizations in its final promulgation of the 1967 regulations was, as the government implies, meaningless or, as the government asserts, there really is no difference between charitable organizations and business leagues. Neither point is supportable.

1. Example 7 intentionally addressed an organization exempt under section 501(c)(6).

All words in a statute or regulation are assumed to have been used for a particular purpose, and to have their ordinary meaning. *Escondido Mutual Water Co. v. LaJolla, Rincon, San Pasqual, Pauma & Paula Bands of Mission Indians*, 466 U.S. 765 (1984); *National Insulation Transportation Committee v. ICC*, 683 F.2d 533 (D.C.Cir. 1982). Among the other five examples applying the principles established in section 1.513-1(d)(4) of the regulations, no specific designation was supplied where the example was intended to apply across the board to all exempt organizations (*see, e.g.*, Example 4). There are several score of "examples" in the regulations pertaining to the UBIT; some refer to organizations exempt under specific paragraphs in section 501(c), others generally refer to "exempt organizations," and the remainder refer specifically to a particular type of organization, such as a "hospital", "trade association", or "university." *See* Appendix A to this Brief. The government has no explanation for such distinctions, and contends that they are "accidental" and meaningless (Gov't Br. 45). Yet the IRS took the trouble to change Example 6 from its original reference to "exempt trade organizations" to the more limited and precise reference to a (c)(6) organization.

It was perfectly appropriate for Treasury to use specific categories of exempt organizations in the examples, because the

statute and the regulations necessarily require examination of the relationship of activity to purpose, and the same type of activity might well be substantially related to the exempt purpose of one organization but not to another having a different exempt purpose. The Court must presume that the narrowed reference in Examples 6 and 7 to a (c)(6) organization was advertent and meaningful.

2. Organizations exempt under sections 501(c)(3) and (c)(6) have materially different purposes and cannot be equated for purposes of section 513 and the regulations.

One of the more surprising aspects of the government's position is the suggestion that there really is no material difference between organizations exempt under sections 501(c)(3) and (c)(6) (Gov't Br. 33-40), and that the reference in Example 7 to a (c)(6) organization should be read as encompassing both categories. The government asserts that exempt organizations "can generally choose to be organized under either" provision, and if Example 7 does not apply to a (c)(3) organization the payment of tax on advertising income would be "elective" (*id.* at 39). The government further suggests that in no instance has IRS (or anyone else) distinguished between organizations exempt under sections 501(c)(3) and (c)(6) for purposes of determining whether advertising is "substantially related," a distinction the government's brief calls "utterly unprecedented" (Gov't Br. 36).

In fact, however, only a few days before the government filed in this Court its reply memorandum in support of its Petition in this case, in which it first aired this suggested equivalence of (c)(3) and (c)(6) organizations (pp. 4-8), IRS itself issued a National Office Technical Advice Memorandum ruling stating that the decision of the court of appeals *in this case* does not apply to ads in publications of a business league exempt under (c)(6) because this case involved a (c)(3) organization. LTR

8538006 (June 17, 1985). [42] As IRS noted, the exempt purposes of a (c)(6) organization — to which the activity must contribute importantly — differ from those of a (c)(3).[43]

The same distinction was dispositive in *Louisiana Credit Union League v. United States*, *supra*, where the Fifth Circuit, distinguishing its earlier decision in *Hi-Plains Hospital*, reasoned that "because *Hi-Plains* dealt with a tax-exempt hospital rather than a business league, its analysis of the substantial relationship inquiry necessarily differs from that adopted here." 693 F.2d at 538 n.24. The hospital in question was a (c)(3) organization, while the credit union league was a (c)(6). The *Louisiana Credit* court found the League's tax-exempt function "a critical factor in the substantial relationship equation." *Id.* at 535. As a (c)(6) organization, the credit union league was directed to the common interest of its members in the improvement of business conditions, and the benefit of the members as a group rather than in their individual financial capacities. *Id.* Thus, any activity that did not generate inherently group benefits that accrued to its members in their capacities as members rather than individuals did not

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42. The College notes this ruling not as binding precedent but merely as evidence of IRS's analytical methodology in which the category of exempt organization is, quite properly, highly material in applying section 513. "[S]uch rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws." *Hanover Bank v. Commissioner*, 369 U.S. 672, 686-87 (1962).

43. The government below endorsed this approach before the court of appeals, stating:

> In any situation in which a determination must be made as to whether a particular business activity "contributes importantly" to the exempt function of an organization, the court must first clearly identify the purposes of the organization, and then carefully inquire into how one or more of those purposes is promoted by the business activity. *Since a business league is a different type of exempt organization, with a different kind of exempt function, analysis of how a business activity is directly related will naturally differ from the same inquiry involving a different organization, such as a hospital with different exempt functions.*

Brief for Appellee, p. 19 (emphasis added).

contribute importantly to the purposes underlying its exemption as a business league under (c)(6). *Id.* at 536. *Accord*, *Professional Insurance Agents v. Commissioner*, *supra*, 726 F.2d at 1103. [44]

In a case involving a (c)(6) organization, the government can argue, as it did in *Louisiana Credit*, that the advertising activity promotes the individual interests of members rather than their common interest in the advancement of industry objectives. Because a (c)(3) can serve charitable, scientific, or educational interests of individual members, not just group objectives, such a limitation is inapplicable in a case involving a (c)(3) organization such as the College.

The (c)(3) category of exemption is distinguishable from (c)(6) in several other significant respects. Because of their different purposes, organizations exempt under (c)(3) and (c)(6) have been identified by Professor Bittker as prime examples of two fundamentally different categories into which the 20-some categories of exempt organizations may be classified: "public service" organizations (including (c)(3)'s) and "mutual benefit" organizations (including (c)(6)'s). B. Bittker & G. Rahdert, *supra*, 85 Yale L.J. at 305.[45] "The promotion of health, like the relief of poverty and the advancement of education and religion, is one of

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44. In *American Bar Endowment v. United States*, 761 F.2d 1573 (Fed. Cir. 1985), *petition for cert. filed*, No. 85-599, income received by the Endowment, a section 501(c)(3) organization, from the furnishing of group insurance benefits for its members was held tax-exempt. In holding that the insurance/fundraising program at issue was not a "trade or business," the court distinguished the insurance program in *Louisiana Credit* primarily because it involved a (c)(6) business league rather than a (c)(3) charitable organization. The charitable purpose meant that a payment to a (c)(3) could properly be regarded as a charitable contribution, while a comparable payment to a (c)(6) business league was a business deduction. *Id.* at 1577. Relatedness was not in issue.

45. Professor Bittker describes "public service" organizations, such as charitable, educational, and scientific organizations, as those that assume part of the burden of government and the income of which is irrevocably dedicated to nonprofit purposes. 85 Yale L.J. at 332; *see Bob Jones University v. United States*, 461 U.S. 574, 587-88 (1983). By contrast, "mutual benefit" associations, such as business leagues, are not directed outward but are best viewed "as conduits through which the members pursue their own ends." 85 Yale L.J. at 306.

the purposes in the general law of charity that is deemed beneficial to the community as a whole. . . ." *Exempt Organization Handbook* ¶349.1(2), 4 Int. Rev. Manual (CCH) 20,583-5 (1982). Moreover, in addition to being the oldest category,[46] (c)(3) status entails both benefits and burdens not associated with other categories, such as business leagues exempt under (c)(6) with respect to UBIT[47] and other matters.[48]

The government contends, as *Louisana Credit* recognized, that some forms of educational activity may be a permissible means of furthering the mutual benefit purpose of a business league (Gov't Br. 35). However, education is not itself a statutory rationale for exemption of a business league under section

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46. The exemption for charitable, scientific and educational organizations dates from the Tariff Act of 1894, ch. 349, §32, 28 Stat. 509. Business leagues were not exempt until 1913. Revenue Act of 1913, ch. 16, §IIG(a), 38 Stat. 114.

47. Section 513(a) excludes from taxation any trade or business activity carried on by organizations exempt pursuant to a few of the 23 subsections of section 501(c), including (c)(3) but not (c)(6), "primarily for the convenience of" its members. Section 513(d), on the other hand, enacted in 1976, establishes a special limitation on the definition of "unrelated trade or business" for convention and trade show activities limited to (c)(5) (labor, agricultural, or horticultural) and (c)(6) organizations. Under this exemption, income from such organizations' exhibitions is deemed to be related if their purpose is the display of industry products, the stimulation of interest and demand for such products or services, or the education of persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry. I.R.C. §513(d)(3). This focus on industry objectives is consistent with not only the "mutual benefit" characterization recognized by Professor Bittker, but the regulations defining the exempt functions of business leagues and the methodology employed in *Louisiana Credit*. Prior to the 1976 legislation, IRS had issued a series of rulings concerning trade show income which had focussed on the "potential informational value" of the exhibits, as well as whether selling or order-taking occurred. Rev. Rul 75-516 through 75-520, 1975-2 C.B. 220-27. In view of the legislation, these rulings were recently revoked as obsolete. Rev. Rul. 85-123, 1985 I.R.B. 32, 8.

48. A (c)(3) organization may not engage in lobbying or other political activity permitted to a (c)(6). *See generally Regan v. Taxation with Representation*, 461 U.S. 540 (1983). Contributions to a (c)(3) organization are deductible, while contributions to a (c)(6) are not. I.R.C. §170. For a fuller discussion of the many distinctions between organizations exempt under (c)(3) and other exempt organizations, *see generally* Treusch & Sugarman, *supra*.

501(c)(6).[49] By contrast, educational, scientific, and charitable activities must be the *exclusive* purpose for which a (c)(3) organization is both organized and operated. *Cf. Better Business Bureau v. United States*, 326 U.S. 279, 283-85 (1945) (noting "unmistakable demarcation" between organizations exempt under (c)(3) and (c)(6)).

Because of the different roles of education of the members as a purpose underlying exemption under sections 501(c)(3) and (c)(6), the importance of the contribution to that purpose of the same educational activity (*e.g.*, publication of specialized advertising, even the same ads) can differ from one category of exempt organization to the other. Therefore, even if it is valid to presume that publication of professional interest advertising does not "contribute importantly" to the exempt purposes of a (c)(6) business league as described in Example 7, it does not logically or rationally follow that such advertising cannot contribute importantly to the exempt purposes of a (c)(3) organization. A decision affirming the court of appeals would not foreclose the application of Example 7 in an action involving a mutual benefit organization, since the difference in purposes is precisely one of the crucial "facts and circumstances" that the governing applicable principles of the regulations proclaim to be determinative.[50]

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49. The government relies upon *National Leather & Shoe Finders Ass'n v. Commissioner*, 9 T.C. 121 (1947), a decision in which IRS did not acquiesce, and where the court merely ruled that an organization was properly exempt under (c)(6). The provision of unspecified educational activities to further industry purposes was noted as one of the organization's activities, but was not the principal basis for its exemption.

50. The government argues that the College's emphasis on the differences in the purposes of organizations exempt under sections 501(c)(3) and (c)(6) represents a belated "shift[ing of] gears" first reflected in the College's pretrial brief (Gov't Br. 33). The government also contends that the College's argument that Example 7 should be limited (in accordance with its terms) to (c)(6) organizations has not been endorsed by any court (*id.* at 36). As we have noted (*see* p. 8, *supra*), in *ACP I* the College made the same contention, with the evident agreement of the Court of Claims in ruling that the issue was "essentially factual," and in this case the government endorsed that determination in *ACP I* in contending in the court of appeals that the issue in this case was "one of fact" (Brief for Appellee pp. 3, 8, 9).

Even if in some instances the question of whether an organization should be exempt under (c)(3) or (c)(6) may be difficult, once the decision is made, the consequences are numerous and important. In the instant case, the College is exempt under (c)(3) as a public service organization and it may not be treated as a "mutual benefit" business league exempt under (c)(6). The issue of the application of Example 7 properly awaits a (c)(6) case.

C. The record does not establish a basis for applying any *per se* rule in Example 7 to the College.

Aside from the fundamental differences between (c)(6) and (c)(3) organizations, there are additional ways in which the *per se* rule imputed to Example 7 is inapplicable to this case. The advertising described in Example 7 is materially different from the advertising published in *Annals*. Example 7 posits that the advertising is "designed and selected in the manner of ordinary commercial advertising," and that its informational function is "incidental" and "differs in no essential respect from the informational function of any commercial advertising." Here, the government argues that the informational function of the College's ads is "incidental" because it may have been secondary "to the purpose of raising revenues" (Gov't Br. 31-32). This confuses two distinct issues.

The evidence is undisputed that the content of the particular ads (mainly for prescription drugs) contributed importantly to significant charitable, scientific, and educational purposes of the College by assisting physicians in developing "more enlightened prescribing habits" (J.A. 59a-60a), in addition to producing income essential to other parts of the College's activities. This results from the unique nature of prescription drug ads, in which by government mandate the informational function *for the reader*, whose professional responsibility it is to prescribe the drug most effective in treating a particular patient (J.A. 59a-60a), is at least as important as the function for the advertiser of stim-

ulating demand (*see* pp. 3-4 *supra*).[51] Although the government repeatedly omits reference to this limitation in stating its *per se* rule, Example 7 is limited to ads having an informational function that "differs in no essential respect from the informational function of any commercial advertising." Treas. Reg. § 1.513-1(d)(4)(iv). Indeed, the government itself asserts that the "educational character" of the advertising is determinative (Gov't Br. 38-39), a test that requires consideration of the content of the ads and their informational value to the reader, not the advertiser's purpose.[52]

The record in this case is devoid of a factual basis for the application of a *per se* rule based on Example 7. In the trial court the government contended that all facts required for disposition of the case were set forth in the written stipulation of facts (Trial Br. of United States 2). That stipulation (J.A. 16a-18a) does not address the question whether the advertising in *Annals* was "designed and selected in the manner of ordinary commercial advertising." Nor was that evidentiary deficiency in the government's case cured by other evidence elicited at trial. The record addresses only the advertising in *Annals*, and not how other advertising is designed and selected.[53] The defects in the

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51. Indeed, because the government mandates the content and format of a major portion of the costly space devoted to prescription drug ads, it is fair to say that in substantial part such ads serve not the private commercial purposes of the advertiser, but rather a public purpose.

52. "[I]t is hard to understand how motive — particularly the advertiser's rather than the publisher's — can control whether the advertising in fact substantially forwards the exempt functions." Barlow, *The New Treasury Tax on Exempt Organization Advertising: A Postscript and a Preview*, in *Tax Problems of Non-Profit Organizations* 239, 256 (Webster ed. 1968). *See also* Liles & Blum, *supra*, 39 Law & Contemp. Prob. at 55 n.336.

53. The only evidence concerning advertising other than that in *Annals* established the irrelevant fact that "some" identical ads appeared in both *Annals* and medical journals published by non-exempt organizations (J.A. 18a). The record does not reveal to what extent this was the case, though it is not surprising in view of the pervasive regulation of the content and format of prescription drug ads. The government asserts that the Claims Court concluded, based on its findings concerning the similarity of some of the ads, that the College's ads "were 'designed and selected in the manner of ordinary commercial advertising' " (Gov't Br. 30, 31, citing Pet. App. 29a). The record does

evidentiary record cannot be cured in this Court by surmise or post-hoc argument by government counsel.

The stipulation also did not establish that the advertisements in question, primarily for prescription drugs, were "garden variety" (Govt. Br. 10) or "ordinary." To the contrary, the record makes clear that prescription drug ads are extraordinary in several pertinent respects. The undisputed testimony of the College's expert witnesses established that prescription drug advertising, which is uniquely informative in its content, plays a crucial role in the improvement of health care through continuing medical education, such that physicians are taught as a matter of good professional practice to review prescription drug ads (J.A. 26a, 44a) (*see* pp. 4-7, *supra*). Given these undisputed facts, if prescription drug advertising is "ordinary commercial advertising," that term has no meaning, for there is virtually no advertising which it would not embrace.

If the College's evidence was to be nullified by a *per se* rule, the government was obliged to establish the preconditions for applying the rule. This it failed to do.

D. If Example 7 establishes a *per se* rule applicable to this case, it is invalid.

If Example 7 should somehow be found applicable in this case, and to establish a *per se* rule deeming all advertising taxable, it should be invalidated as contrary to the Code and the remainder of the regulations. The government asserts that the regulations make "absolutely clear" that, regardless of the category of organization or exempt purpose, as a matter of law there can be no difference in the importance of the contribution to exempt purposes of any type of advertising, whether "general

NOTES (*Continued*)

not permit such a finding, unlike ordinary commercial advertising the content and design of prescription drug ads is largely mandated by the government, and the record addresses the manner of selection only with respect to *Annals*. Moreover, the Claims Court made no such finding or conclusion, but was merely discussing Example 7, to which the court saw some, but not necessarily a complete, "resemblance."

consumer advertising," "for products like soft drinks," or "professional interest advertising" "for products like drugs" (Gov't Br. 8). Whether or not such a *per se* rule or conclusive presumption would be valid if limited to (c)(6) business leagues — the only organizations to which Example 7 purports to apply[54] — it would be invalid if applicable in this case, involving a section 501(c)(3) organization that has shown that in fact the uniquely informative advertising in its journal contributes importantly to its exempt purposes.[55]

The government's position concerning the broad *per se* scope of Example 7 is fundamentally at odds with the regulation itself. The portion of the regulations setting forth the "applicable principles" (§ 1.513-1(d)) stresses the need in "each case" for careful examination of all the "facts and circumstances" in order to determine whether specific activities of an exempt organization "contribute importantly" to the particular purposes underlying that organization's exemption, and, if so, whether they are conducted on a larger scale than is reasonably necessary. The government's broad *per se* rule cannot be squared with that governing principle.

Beyond that basic inconsistency, the content of the government's broad *per se* rule is itself suspect if applicable to the College, for it lacks a rational basis: the manner in which advertising for a professional journal is designed and selected has no rational or discernible relationship to whether — in general or in a particular case — the same ads contribute importantly to

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54. Although the College has not challenged the validity of Example 7 if limited to (c)(6) organizations, serious questions are being raised by the amicus American Medical Association as to the invalidity of Example 7 even as to (c)(6) organizations. These questions lend further support to the arguments against finding Example 7 applicable in the instant case.

55. See pp. 2-7 *supra*. Because the Treasury regulations expressly call for individualized determinations based on the "facts and circumstances" of "each case," this is not a situation where Congress or the agency has concluded that "the difficulties of individual determinations outweigh the marginal increments in the precise effectuation of congressional concern which they might be expected to produce." *Weinberger v. Salfi*, 422 U.S. 749, 785 (1975).

the accomplishment of the exempt purpose of a (c)(3) organization. Nor is it discernible how the similarity *vel non* of such design and selection to the design and selection of "ordinary" commercial ads could determine the importance of the contribution of any type of advertising to the exempt purposes of any category of exempt organization.

While Treasury's interpetive regulations are due modest judicial deference where they are in accordance with their statutory underpinnings, they must be overturned where in conflict with the statute or otherwise in excess of legislative authority. *See Commissioner v. Engle*, 464 U.S. 206, 224-25 (1984); *American College of Physicians v. United States*, *supra*, 530 F.2d at 932; 5 U.S.C. § 706. So here, if interpreted to state a *per se* rule of taxation of advertising income applicable to the College, Example 7 must be invalidated.

To avoid having to address the questions that would be raised as to the validity of the regulation if requiring application of a conclusive presumption in this case, under customary prudential principles this Court ought to construe the regulation narrowly, as it is possible to do. *E.g., United States v. Grace*, 461 U.S. 171, 175-76 (1983); *Brockett v. Spokane Arcades, Inc.*, 105 S.Ct. 2794 (1985). For the same reason the Court must also examine with care the justification proffered for applying the government's *per se* presumption in this case.

IV. The Court of Appeals' Decision Does Not Sanction Unfair Competition, Impose Substantial Costs, Nor Require a Novel or Burdensome Case-By-Case Analysis.

The government's argument concludes with several policy contentions that seem irrelevant to the merits, but are in any event without merit. The government argues in this Court that the decision below will result in substantial revenue loss by opening a broad "loophole" for income from advertising in a wide range of professional and trade journals (*id.* at 41). Outside this Court, however, the IRS evidently regards the case as being

"narrow" in scope[56] and limited to (c)(3) organizations (*see* pp. 37-38, *supra*).

The government repeatedly asserts that the court of appeals' decision will impose some novel case-by-case approach to application of section 513 (*e.g.*, Gov't Br. 7, 27, 41, 42).[57] A case-by-case approach in this area, however, is not novel (see, *e.g.*, pp. 31-33 *supra*). It is compelled by the standard adopted by Congress ("substantially related" to exempt purpose); has been a fundamental principle of the regulations since 1958 (relatedness depends on "particular circumstances"); was augmented in the 1967 regulations (requiring a determination whether the activity "contributes importantly" and is "conducted on a larger scale than reasonably necessary"[58] and is required by Example 7 itself (*e.g.*, whether advertising has only an "incidental" informational function and is "designed and selected in the manner of ordinary commercial advertising").

The impact of the decision below (on revenues or audit resources) will be limited because few exempt organizations will be

56. An IRS special assistant for exempt-organization matters told a briefing sponsored by the American Association of Executives that this case was "a factually narrow dispute that is not of as much benefit to associations as they would like to think." *Inside ASAE*, Vol. 1, No. 18, p. 2 (March 22, 1985).

57. The government to the contrary, the court of appeals' decision does not require an "ad-by-ad" approach (Gov't Br. 7, 27, 41), since only if the organization can show that as a whole the advertising "contributes importantly" will further scrutiny be necessary. The government cites testimony by a witness in the House hearings to the effect that to draw the line "on an individual basis" would create an insurmountable audit burden for IRS (Gov't Br. 42). However, the witness was not IRS but a non-exempt publisher who favored a broad reading of the regulations, and it is not at all clear what type of line-drawing he meant. IRS has had no difficulty applying these or many other provisions of the Code and regulations on a case-by-case basis, and there is no reason to apprehend any particular new problems under the decision below.

58. The government argues that rejection of its *per se* rule would confer "immunity" from UBIT (Gov't Br. 29). However, the regulations make clear that if a related trade or business is "conducted on a larger scale than is reasonably necessary for performance of the exempt functions," then income attributable to the activities in excess of the needs of exempt functions may be taxable. §1.513-1(d)(3). No such issue arises in this case because, as the court of appeals noted, the government made no effort in this case to make such a showing (Pet. App. 19a-20a).

able to present as strong evidence linking advertising with their exempt purposes as did the College at trial. The specialized advertising in *Annals* is not merely "useful" or "educational" to internists, but contributes importantly to their ability to cure disease and improve the health care provided to their patients. Few ads will be as informational or "educational" as the prescription drug ads in *Annals*. Moreover, few organizations, given their purposes, really have a free choice between (c)(3) and (c)(6) designation, and the choice where present is dictated by numerous other considerations. The prospect of an influx of (c)(3) organizations seeking to take advantage of the decision below is fanciful, at best, particularly in view of the difficulty of satisfying the "contributes importantly" standard.

The government also contends that the court of appeals decision has "flouted" the "sharply defined legislative policy" concerning competition by exempt organizations (Gov't Br. 41, 43). However, Congress did not enact any legislative policy concerning competition apart from the provisions of section 513, which, as noted, makes exemption turn on relatedness without regard to competition (*see* p. 16 *supra*). The decision below faithfully applies the only legislative policy enacted by Congress in this area — section 513 — and is not inconsistent with any other discernible policies concerning competition.[59]

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59. As noted, the College set its advertising rates at levels comparable to those set by non-exempt publishers, and was not undercutting them (*see* p. 3 n.3 *supra*). Neither the government nor ABP has identified any anticompetitive or unfair aspect of the College's publication of advertising. Ironically, if the College followed the government's suggestion and included advertising "free of charge" (Gov't Br. 43) — a suggestion not endorsed by ABP — it might be charged with engaging in the ultimate form of predatory, unfair competition. In any event, the government's reliance upon the fact that advertisers are charged a fee (Govt. Br. 43) is misplaced, for it is a premise in every section 513 case that the activity generated income. Thus, that a fee was charged is irrelevant to whether the activity is "substantially related" *vel non*.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals for the Federal Circuit in favor of respondent The American College of Physicians should be affirmed.[60]

Respectfully submitted,

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60. Because of the limited nature of the issue actually presented by this case, the writ of certiorari could appropriately be dismissed as having been improvidently granted.

Appendix A

Summary of Illustrative Examples Contained in Current Regulations Under Code Sections 511 through 514 (UBIT)

Regulation Section	Type of Organization
1.511-2(c)(2) Example	§501(c)(2)
1.512(a)-1(e) Example	Business league
1.512(a)-1(f)(2)(iii) Examples 1,2,3,4	Trade association
1.512(a)-1(f)(5) Examples 1 & 2	Scientific organization
Example 3	Trade association
1.512(a)-1(f)(7)(iii) Example	Trade association
1.512(a)-3(a)(2) Example	Social club
1.512(a)-3(b)(2)(ii) Example	Social club
1.512(a)-3(c)(2)(iv) Example	Social club
1.512(a)-3(c)(3)(iv) Example	Organization of fraternities
1.512(a)-3(c)(4) Example	Social club
1.512(a)-3(d)(2) Example	§501(c)(2) and social club
1.512(a)-3(d)(4) Example	§501(c)(2) and §501(c)(7)
1.512(a)-3(e)(8) Example	Social club
1.512(b)-1(c)(2)(iv) Example	Exempt organization
1.512(b)-1(c)(4) Examples 1,2,3,4	Exempt organization
1.512(b)-1(h)(2)(ii) Example	Association of churches
1.512(b)-1(i)(1)(ii) Example	Church under §1.511-2(a)(3)(ii)
1.512(b)-1(1)(2)(ii) Examples 1,2	Scientific organization under §501(c)(3)
1.512(b)-1(1)(3)(iii) Examples 1,2	University under §501(c)(3)
1.513-1(d)(4)(i)	
Example 1	§501(c)(3)
Example 2	§501(c)(5) trade union
Example 3	§501(c)(6) trade association
1.513-1(d)(4)(iv)	
Example 1	Scientific organization
Example 2	University
Example 3	Business league
Example 4	Musical organization
Example 5	University
Example 6	§501(c)(6)
Example 7	§501(c)(6)
1.513-3(c) Examples 1,2,3,4	§501(c)(6)
1.513-5(c)(3) Examples 1,2	Exempt organizations
Example 3	Veterans' organization

1.513-6(c) Example	Hospital
1.514(a)-1(a)(1)(iv) Example	Trade association
1.514(a)-1(a)(2)(iv) Example	Educational organization
1.514(a)-1(a)(3)(iii) Example 1	Educatational organization
Example 2	Exempt organization
1.514(a)-1(a)(4)(iv) Example	Trade association
1.514(a)-1(b)(4)(ii) Example	Educational organization
1.514(a)-1(b)(5)(ii) Example	Exempt organization
1.514(b)-1(b)(1)(iii) Example 1	Exempt organization
Examples 2,3	College
1.514(b)-1(b)(3) Example 1	Scientific organization
Example 2	Exempt organization
Example 3	University
1.514(b)-1(c)(2)(iii) Example 1	§501(c)(6)
Examples 2,3,4	§501(c)(5)
1.514(b)-1(c)(3)(ii) Example	§501(c)(3)
1.514(b)-1(d)(3)(i)(b)	
Examples 1,2,3,4	University
1.514(b)-1(d)(4)(ii) Example	Exempt organization
1.514(c)-1(a)(2) Example 1	Exempt organization
Example 2	Scientific organization
Example 3	Private school
Example 4	Exempt organization
1.514(b)-1(b)(3)(iv) Examples 1,2	§501(c)(3)
1.514(b)-1(e)(3) Example 1	Exempt organization
Example 2	University
1.514(d)-1(b)	Exempt trust

(14)

No. 84-1737

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In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

In our opening brief, we contend that this case is governed by Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7), which Congress explicitly endorsed in 1969. That Example concerns a tax-exempt professional association which, like respondent, has among its goals the "continuing education of its members in matters pertaining to their profession" (*ibid.*). The Example addresses the publication by such an association in its professional journal of advertising which, like respondent's advertising, "promotes only products which are within the general area of professional

interest of its members" (*ibid.*). The Example concludes that the association's "publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute" (*ibid.*). Such commercial publicity, the Example observes, "differs fundamentally from [an educational] activity both in its governing objective and in its method," since "the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products" (*ibid.*). The Example accordingly concludes that the publication of commercial advertising does not "contribute importantly" to the accomplishment of the association's educational purposes and that its advertising revenues are subject to tax (*ibid.*).

In contending that *its* publication of commercial advertising *does* contribute importantly to the accomplishment of *its* educational purposes, and that its advertising revenues should be immune from tax, respondent seeks to avoid Example 7 in three ways. First, it contends that its advertisements are "uniquely informative" (Br. 35) and "materially different" (*id.* at 42) from the advertisements in Example 7. Second, it contends (*id.* at 35-42) that Example 7 does not apply to it. Third, it contends (*id.* at 44-46) that the Regulation is invalid. We anticipated each of these contentions in our opening brief and have shown each to be wrong. Several of respondent's assertions, however, warrant a brief reply.

1. In asserting that its advertisements are "materially different" (Br. 42) from those described in Example 7, respondent relies principally on what it

calls "the pervasive regulation of the content and format of prescription drug ads" by the Food and Drug Administration (Br. 3, 43 n.51, 43-44 n.53). As a result of FDA rules "specifying the required and prohibited editorial content of prescription drug ads," respondent says, the "content and design of [such] ads is largely mandated by the government" (*id.* at 3, 44 n.53). Compliance with FDA regulations assertedly makes respondent's ads "uniquely informative" (*id.* at 35), so that "in substantial part [they] serve not the private commercial purposes of the advertiser, but rather a public purpose" (*id.* at 43 n.51). Respondent thus concludes that its advertising, unlike that in Example 7, is not "designed and selected in the manner of ordinary commercial advertising" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)).

The FDA's rules governing prescription drug advertising have their genesis in the Federal Food, Drug, and Cosmetic Act, ch. 675, 52 Stat. 1040 *et seq.* As amended by the Drug Amendments of 1962, Pub. L. No. 87-781, § 131, 76 Stat. 791-792, the Act requires inter alia that manufacturers include in their advertisements for prescription drugs a "brief summary" describing the product's "side effects, contraindications, and effectiveness" (21 U.S.C. 331, 352(n)). Under FDA regulations, this summary must be "true" and must "present a fair balance" concerning "the selected purpose(s) for which the drug is recommended or suggested in the advertisement" (21 C.F.R. 202.1(e)(3)(ii)). So-called "reminder advertisements," which merely "call attention to the name of the drug product" without including indications or dosage recommendations for its use, are exempt from these rules (21 C.F.R. 202.1(e)(2)(i)).

There is no merit whatsoever to respondent's assertion that, in consequence of these FDA regulations, the "content," "design," and "format" of its drug advertisements are "largely mandated by the government" (Br. 3, 43 n.51, 43-44 n.53). While the FDA sets forth general guidelines designed to prevent drug ads from being false or misleading, the basic decisions about what will be said in each ad, and how it will be said, remain the province of the advertisers, who enlist the considerable literary and promotional skills of Madison Avenue in an effort to sell their wares. The FDA does not require that respondent's ads depict happy faces beaming down on bottles of Robitussin (Pet. App. 56a), project full-page illustrations of the Great Wall of China to promote angina medication (*id.* at 66a), or show shapely calves, well-stockinged in support hose, in close proximity to footballs (*id.* at 62a). The FDA rules in some instances may require that respondent's ads, like those described in Example 7, provide certain information in order 'to comply with * * * general standards of taste, fairness, and accuracy" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). "[B]ut within those limits the form, content, and manner of presentation of [respondent's] advertising messages," as of the advertising messages described in Example 7, "are governed by the basic objective of the advertisers to promote the sale of the advertised products" (*ibid.*). Cigarette advertisements, like prescription drug advertisements, are subject to "pervasive regulation" (Resp. Br. 43 n.53) by the government. See 15 U.S.C. 1331 *et seq.* But it could scarcely be contended that scenes of cowboys riding into the sunset are "uniquely informative" (Resp. Br. 35) or "materially different" from other commercial advertising messages (*id.* at

42) by virtue of including the Surgeon General's warning. See 15 U.S.C. 1333.

In seizing upon the FDA regulations to differentiate drug ads from the common run of taxable commercial advertising, respondent and amici reiterate in this Court arguments that they unsuccessfully made to Congress in 1969. See, *e.g.*, *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. 1114, 1119, 1200, 1260-1261, 1391. The American Medical Association, amicus here, emphasized before Congress what "[t]he food and drug law requires" of prescription drug ads in an effort to demonstrate that "[n]o other advertising provides as much complete and objective information" (*id.* at 1261). The American Psychiatric Association told Congress that it should "be thankful that we have such informative drug advertisements, regulated as they are by the Food and Drug Administration" (*id.* at 1119). And respondent itself testified that the ads in its journal provide a "thumbnail sketch of what [a prescription] drug does, what its contraindications are, what its precautions are, what its warnings are," all "according to Food and Drug Regulations" (*id.* at 1114). Unpersuaded by their testimony, Congress expressly approved the challenged regulations, noting that they "mainly affected the advertising income of publications such as medical journals," the bulk of whose advertisements, then as now, promoted prescription drugs. H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969).

Respondent's effort to differentiate its ads from those in Example 7 is thus unavailing. The FDA regulations obviously do not distinguish respondent's drug ads from those appearing in taxpaying medical journals—many of whose ads "were identical" to re-

spondent's (Pet. App. 28a)—since those regulations, applicable as they are to all prescription drugs in interstate commerce (21 U.S.C. 331), cover drug advertising nationwide. And the FDA regulations do not distinguish respondent's ads from those described in Example 7, since those ads likewise couple a predominately commercial message with certain information designed to ensure compliance with "general standards of taste, fairness, and accuracy." The Claims Court's findings of fact, encapsulated in its determination that respondent's advertising "was typical commercial publicity" (Pet. App. 28a), show that respondent's ads, like those in Example 7, were "designed and selected in the manner of ordinary commercial advertising." See U.S. Br. 30-31. Example 7 accordingly dictates that respondent's advertising profits are subject to tax.[1]

2. Respondent alternatively contends (Br. 18-20, 35-42) that, if its advertising should be deemed to resemble that in Example 7, the principles of Example 7 should not apply to it, tax-exempt as it is under Section 501(c)(3), but rather should apply only to advertising published by professional associations that are tax-exempt as "business leagues" under Section

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[1] Amicus curiae American Society of Association Executives (Br. 19-26) supports respondent's contention that its commercial advertising, notwithstanding Example 7, should be deemed "substantially related" to its educational purposes. The counsel of record for that association, however, took a rather different view of the Regulation in 1969. "[I]t is arguable," he wrote following the enactment of Section 513(c), "that there can still be 'related' advertising. However, the legislative history and intent of the Congress is so clear that the likelihood of this argument prevailing as to any period after December 31, 1969 is very improbable." Webster, *Unrelated Business Income*, 23 Tax Law. 471, 476 (1969).

501(c)(6). But as we showed in our opening brief (at 34-40), the subsection of Section 501(c) under which a tax-exempt publisher happens to be organized makes no difference in determining the educational character of the advertising that it publishes. Example 7 concludes that ordinary commercial advertising like respondent's is not "educational" in the sense intended by the tax-exemption statute because its "informational function is incidental to the controlling aim of stimulating demand for the advertised products" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). Obviously, that conclusion logically applies regardless of the source of the publisher's tax exemption: it is the educational character vel non of the *advertising* that determines the application of the unrelated business income tax.

We further explained in our opening brief (at 35, 38-39) that Example 7 could not sensibly be read as respondent would read it, since professional associations like respondent generally have the option of qualifying for tax exemption *either* under Section 501(c)(3) *or* under Section 501(c)(6). Respondent professes to find this "[o]ne of the more surprising aspects" of our brief, contending that "[t]he (c)(3) category of exemption is distinguishable from (c)(6) in several * * * significant respects" (Br. 37, 39). We of course agree that there may be significant differences *at the margins* between some Section 501(c)(3) groups (such as churches) and some Section 501(c)(6) groups (such as professional football leagues). Our point was rather that any such differences are generally slight *in the case of professional associations like respondent*—organizations that draw their membership exclusively from a single profession and that have broad educational or charitable goals (U.S. Br. 35, 38).

Respondent studiously avoids controverting the point that we actually made (see Resp. Br. 42), and the briefs filed by amici curiae herein demonstrate that our point is correct. Amicus Massachusetts Medical Society recites that it is "the oldest American medical association in continuous existence," that its principal purposes include the promotion of health care and the "conduct of educational programs," and that it publishes "journals and periodicals * * * devoted primarily to the science and practice of medicine." Brief for the American Medical Association and the Massachusetts Medical Society as Amici Curiae at 2. Amicus American Medical Association recites that it "was founded in 1846 to promote the science and art of medicine and the betterment of public health" and that it "publishes scholarly medical journals in furtherance of its exempt purposes" (*id.* at 1-2). These two associations recite exempt purposes virtually identical to respondent's (see Resp. Br. 2), yet both are tax-exempt under Section 501(c)(6) rather than under Section 501(c)(3).

There is thus no merit to respondent's assertion that the reference in Examples 6 and 7 to "an association exempt under Section 501(c)(6)" reflects a deliberate decision on the Treasury's part (Resp. Br. 36) to confine those Exemples' analysis to publishers that rely on Section 501(c)(6) as the source of their exemption. The principles of Examples 6 and 7 have been universally understood—by Congress, the courts, the Internal Revenue Service, scholarly commentators, and witnesses (including respondent itself) who testified concerning the Regulation before Congress in 1969—to apply to tax-exempt publishers across the board. See U.S. Br. 36-38; Rev. Rul. 72-431, 1972-2 C.B. 281 (applying principles of Example 7 to Section

501(c)(3) group); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 484 n.19 (1979) ("While the plausibility and consistency of the Commissioner's interpretation are relevant to the reasonableness of the regulation as applied * * *, the Commissioner is otherwise free to determine how the regulation he has written should be construed."). Examples 6 and 7, like the thousands of other examples incorporated in the Treasury Regulations, are meant to be concrete illustrations of general rules. If they were not particularized, they would not be "examples." To deprive their analysis of any extrapolative force, as respondent would do, is to ignore their function.[2]

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[2] As respondent itself observes (Br. 36 & App. A), the regulations promulgated under the Code's unrelated business income tax provisions include more than 80 examples, and these examples refer to their various tax-exempt subjects in various ways. They sometimes refer generically to "an exempt organization" (Treas. Reg. § 1.512(b)-1(c)(2)(iv) (Example)); they sometimes refer to an organization by its category, *e.g.*, a "scientific organization" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 1)); they sometimes refer to an organization by the subsection under which it is exempt, *e.g.*, "an organization described in section 501(c)(3)" (Treas. Reg. § 1.513-1(d)(4)(i) (Example 1)); and they sometimes refer to an organization by a combination of the latter two methods, *e.g.*, "an exempt scientific organization described in Section 501(c)(3)" (Treas. Reg. § 1.512(b)-1(*l*)(2)(ii) (Example 1)). Examples using business leagues as their subjects reveal the same heterogeneous pattern, referring sometimes to "an exempt business league" (Treas. Reg. § 1.512(a)-1(e) (Example)), sometimes to "an exempt trade association" (Treas. Reg. § 1.512(a)-1(f)(2)(iii) (Example 1)), sometimes to "an association exempt under section 501(c)(6)" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 6)), sometimes to "an organization described in section 501(c)(6)" (Treas. Reg. § 1.513-3(e) (Example 1)), and sometimes to "an exempt trade association described in section 501(c)(6)" (Treas.

3. Respondent finally asserts that Example 7, if construed to reach its advertising, "lacks a rational basis" and "must be overturned [as] in conflict with the statute or otherwise in excess of legislative authority" (Br. 45-46). Respondent understandably proffers this contention hesitantly, since, as we showed in our opening brief (at 18-26), Congress explicitly endorsed the Regulation in 1969. But respondent professes to find that legislative history "contradictory," "scattered," "sketchy and generalized," and as hard to "divine" as "tea leaves" (Br. 21, 25, 27, 33). Noting that the Tax Reform Act of 1969 did not change the statutory definition of "unrelated trade or business" (I.R.C. § 513(a)), respondent argues that "the 1969 legislative history * * * is of little value" in resolving the question presented here (Br. 11). And even if Congress in 1969 should be thought to have endorsed the Regulation "in general," respondent says, Congress surely cannot be held to have approved the Regulation's every jot and tittle, least of all something as lowly as a mere "Example" (Resp. Br. 26 n.31, 29, 34). Respondent notes that the House bill was 368 pages long, and suggests that Examples 6 and 7 may have crept by while Congress, distracted by weightier matters, was looking in the other direction (Resp. Br. 21).

These contentions are wholly insubstantial. To begin with, it is well established that interpretive

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Reg. § 1.514(b)-1(c)(2)(ii) (Example 1)). The randomness of this pattern confirms the common sense observation that the Regulations in their various examples use various types of exempt organizations for illustrative purposes only, and that no weight should be attached to the particular subject used or to the particular formula used to describe it.

regulations of the Treasury, "if found to 'implement the congressional mandate in some reasonable manner,' must be upheld." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 476 (quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973)). The conclusion reached by Example 7—that commercial advertising "differs fundamentally from [an educational] activity both in its governing objective and in its method"—is a logical construction of the term "educational" as used in Section 501(c)(3). As noted in our opening brief (at 43), to the extent a publisher uses commercial advertising as an information-conveying vehicle, charging the advertiser a fee as a condition to publishing the ad, the message is one of the advertiser rather than one to which the publisher would choose to devote its own, general resources. From the publisher's perspective, therefore, any "informational function" of such advertising is, as the Claims Court found, "incidental to its purpose of raising revenue" (Pet. App. 30a). From the advertiser's perspective, similarly, the ads' informational content is just one means of furthering "the controlling aim of stimulating demand for the advertised products" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). Respondent's publication of commercial advertisements, like other commercially-oriented ventures, may, as this Court has observed, "serve incidentally to educate certain persons. But [it is] directed fundamentally to ends other than that of education." *Better Business Bureau* v. *United States*, 326 U.S. 279, 284 (1945). In reaching the same conclusion in Example 7, the Treasury acted well within the scope of its interpretive authority.

Contrary to respondent's contention, moreover, Example 7 has received the explicit endorsement of Congress, and it thus carries with it a particularly

strong, if not an irrebuttable, presumption of correctness. After the Regulation was promulgated, Congress held extensive hearings specifically to consider "whether advertising income should be characterized as unrelated in the case of magazines and other periodicals published by exempt organizations where the editorial matter of the publication is related to its exempt function." *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. 6 (1969). After listening for several days to arguments substantially similar to those respondent and amici voice here, Congress enacted Section 513(c) of the Code, entitled "Advertising, Etc., Activities." In the course of doing so, Congress expressly endorsed the challenged Regulation, noting that it "mainly affected the advertising income of publications such as medical journals" (H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969)). The House stated that, under the statutory standard it was then adopting, "advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore * * * this income should be taxed" (*id.* at 50). The Senate agreed that the Regulations, "insofar as they apply to advertising and related activities, should be placed in the tax laws" (S. Rep. 91-552, 91st Cong., 1st Sess. 75 (1969)). And Examples 6 and 7, contrary to respondent's assertion, were not at the periphery of what Congress endorsed, but were at its core, for it was those Examples that discussed the tax treatment of professional journal advertising, upon which the bulk of the controversy centered.

This Court has repeatedly held that " 'the construction of a statute by those charged with its execution should be followed unless there are compelling indica-

tions that it is wrong, especially when Congress has refused to alter the administrative construction.'" *CBS, Inc.* v. *FCC*, 453 U.S. 367, 382 (1981) (quoting *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969)). Accord, *e.g.*, *Haig* v. *Agee*, 453 U.S. 280, 291 (1981). Here, moreover, by amending Section 513(c) in 1969 to pave the way for the Regulation's enforcement, "Congress has not just kept its silence by refusing to overturn the administrative construction but has ratified it with positive legislation." *Red Lion Broadcasting Co.*, 395 U.S. at 381-382. There is accordingly no basis for respondent's challenge to the validity of the Regulation.

CONCLUSION

For these reasons and for the reasons set forth in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

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IN THE
Supreme Court of the United States
OCTOBER TERM

UNITED STATES OF AMERICA,
Petitioner,

v.

AMERICAN COLLEGE OF PHYSICIANS,
Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR AMERICAN BUSINESS PRESS AS AMICUS CURIAE IN SUPPORT OF THE BRIEF OF THE UNITED STATES

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ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR AMERICAN BUSINESS PRESS AS AMICUS CURIAE IN SUPPORT OF THE BRIEF OF THE UNITED STATES

QUESTION PRESENTED

Is the Unrelated Business Income Tax enacted into law in 1950, as amplified in the Tax Reform Act of 1969 which specifically declared that tax applicable to advertising profits earned from the sale of advertising in periodicals published by tax-exempt organizations, to be invalidated because of an erroneous decision of the United States Court of Appeals for the Federal Circuit holding those advertising profits non-taxable.

INTEREST OF AMICUS CURIAE AMERICAN BUSINESS PRESS

On June 5, 1985 American Business Press (ABP)[1] filed a motion to file an amicus curiae brief in support of the Petition of the United States for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in *American College of Physicians* v. *United States*, 743 F.2d 1570 (1984). Pursuant to Sup. Ct. R. 36.1, ABP's amicus brief accompanied its June 5 motion. On July 1, 1985 this Court entered an order granting ABP's motion, and simultaneously granted the Government's petition for a writ of certiorari. The Solicitor General and Counsel for respondent American College of Physicians (ACP) have consented to ABP's request that it file an amicus curiae brief pursuant to Sup. Ct. R. 36.2.

ABP is the nation's association of leading trade journal publications. Over 500 scientific, professional, educational and other types of specialized periodicals circulated within the United States and throughout the world are published by ABP's members. As this brief and ABP's brief in support of the petition for certiorari show, ABP members in a wide variety of fields edit publications which are in direct competition with periodicals issued by tax-exempt organizations classified as either 26 U.S.C. §501(c)(3) or 26 U.S.C. §501(c)(6) entities. The types of advertising appearing in ABP periodicals and in §501(c)(3) and § 501(c)(6) periodicals are identical.

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[1]On July 1, 1985 the name of the association was changed to Association of Business Publishers. In the interest of continuity, the name American Business Press is used in this brief. The initials "ABP" mean either American Business Press or Association of Business Publishers.

SUMMARY OF ARGUMENT

The common threads of unfair competition and closure of tax-loopholes run through the administrative, legislative and judicial histories of the Unrelated Business Income Tax (UBIT) from the date it was passed by Congress in 1950. Pub. L. No. 81-814, §301, 64 Stat. 906, (1950) (codified at 26 U.S.C. §§511-513). The 1967 Treasury regulations[2] issued pursuant to UBIT specifically applied UBIT to the advertising profits of *all* tax-exempt organizations. The Treasury regulations contain seven examples of exploitation of an exempt function. Appendix A hereto contains Treasury Regulation §1.513-1(d)(4)(iv) headed "Exploitation of exempt functions", which pertains to advertising, and Examples 6 and 7 thereunder, both particularly relevant to the instant case.

Examples 6 and 7 illustrate how the advertising carried in a periodical published by a business league (§501(c)(6) organization) or in a periodical published by a professional society (§501(c)(3) organization) is exploitation[3] of that exempt function. Example 7 issued in *1967* describes respondent ACP's exploitation of *its* exempt function in *1985* precisely.

In the case of a periodical which contains both editorial and advertising content, whether the tax classification of the exempt organization be §501(c)(3) or §501(c)(6), both the Treasury regulations and Congress declared advertising to be unrelated to any tax-exempt purpose and there-

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[2]Treas. Reg. § 1.513-1(d) (1967).

[3]By way of illustration, if the publishing of editorial content in a tax-exempt organization's periodical is a related, tax-exempt function, then the sale of advertising in that periodical is exploitation of an exempt function (editorial content) and the profits earned on that advertising are taxable.

fore taxable. Congress further directed IRS to prescribe accounting regulations "so as to clearly reflect unrelated business taxable income from such activity and to prevent avoidance of unrelated business income tax liability." H.R. Rep. No. 91-413, 91st Cong., 1st Sess., *reprinted in U.S. Code Cong. & Ad. News* 1696 (1969). The accounting regulations (Treasury Regulation §1.512(a)-1 *et seq.*) took effect December 18, 1975. 40 Fed. Reg. 58638.

ARGUMENT

I. IN ADDITION TO TAX COLLECTION THE PRIMARY PURPOSE OF UBIT IS TO PREVENT UNFAIR COMPETITION

Since 1950, the courts of appeal have uniformly emphasized the UBIT purpose of preventing unfair competition. The Fifth Circuit in *Louisiana Credit Union League* v. *United States,* 693 F.2d 525, 539 (5th Cir. 1982) held:

> A fair reading of the legislative history of the Revenue Act of 1950 indicates that Congress indeed was concerned that exempt institutions choosing to enter the marketplace would enjoy an unfair advantage over their taxpaying competitors. See H.R. Rep. No. 2319, 81st Cong., 2d Sess., reprinted in 1950-2 C.B. 380; S. Rep. No. 2375, 81st Cong., 2d Sess., reprinted in 1950-2 C.B. 483; 96 Cong. Rec. 9351, 9366 (1950) (statement of Mr. Lynch). *Congress reiterated its interest in preventing unfair competition when section 513 was amended in 1969.* Similar language accompanied further amendments in 1978. [Footnotes omitted and emphasis supplied][4]

[4]The *1969* amendment to UBIT enacted in 1950, as referred to in *Louisiana Credit Union,* was enacted primarily to deal with advertising in tax-exempt periodicals, particularly in medical journals. This is the Congressional enactment before the Court in the case at bar. The *1978*

In *Hope School* v. *United States,* 612 F.2d 298, 304 (7th Cir. 1980), the Court of Appeals said that unfair competition is "the primary consideration" when a court determines whether a tax-exempt organization is conducting an unrelated trade or business.

The Second and the Sixth Circuits, like the Fifth and Seventh Circuits, have also declared that the purpose of Congress in extending the income tax to the unrelated business income of tax-exempt organizations was to eliminate the unfair competitive advantage over taxpayers that tax-exempt organizations like respondent enjoy when they engage in an unrelated trade or business. *Rensselaer Polytechnic Institute* v. *Commissioner,* 732 F.2d 1058, 1061 (2d Cir. 1984); *Service Bolt & Nut Co.* v. *Commissioner,* 724 F.2d 519, 524 (6th Cir. 1983).

As recently as June 14, 1985, in *American Medical Association* v. *United States,* a case also involving the applicability of UBIT to medical advertising profits, Judge Grady of the United States District Court, Northern District of Illinois, re-affirmed this purpose of UBIT when he wrote:

> It could be argued that a tax law is exclusively a matter of government interest, since its basic purpose is to generate revenue. But case law indicates that the purpose of the tax law and regu-

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amendment referred to by the Court exempted bingo games conducted by tax-exempt organizations and political organizations if those games do not compete with bingo games carried on by for-profit businesses. The 1978 Ways and Means Committee Report referred to by the Court states:

> In general, the unrelated business income tax was imposed to prevent tax-exempt organizations from having an unfair competitive advantage over taxable businesses. . . .

H.R. Rep. No. 95-1608, 95th Cong., 2d Sess., *reprinted in U.S. Code Cong. & Ad. News* 3718 (1978).

> lations here in question is to maintain fair competition between tax-exempt and non-tax-exempt businesses. *See* Rensselaer Polytechnic Institute v. Commissioner of Internal Revenue, 732 F.2d 1058, 1061 (2d Cir. 1984); Louisiana Credit Union League v. United States, 693 F.2d 525, 539 (5th Cir. 1982). Therefore public interest issues similar to those found in antitrust cases appear to be at stake here.

No. 82-C-7213, mem. op. at 11, n.5 (N.D. Ill. 1985).

Congress had ample opportunity in 1978-1981 to reverse its specific position declaring advertising profits of tax-exempt organizations taxable, but did not do so. Congressman Conable introduced H.R. 13740 in the 95th Congress and H.R. 990 in the 96th and 97th Congresses: These bills would have gutted the tax on advertising profits of tax-exempt organizations. No hearings were ever held on them, and no similar bill was introduced in the 98th Congress. Thus the intent of Congress that advertising is an unrelated business activity remains intact to the very date of this brief.

Legislative and judicial precedent notwithstanding, the Federal Circuit utterly disregarded (1) unfair competition, (2) Treasury Regulation § 1.513-1(d)(4)(iv), (3) Example 7 thereunder, and (4) Congressional intent when that Court declared respondent's advertising profits tax-exempt, even though that advertising is identical to that carried by its taxpaying competitors.[5]

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[5]The will of Congress to the contrary, the Federal Circuit erroneously criticized Chief Claims Court Judge Kozinski's decision to apply UBIT to ACP's advertising profits, in stating:

> The trial court's analysis places too great an emphasis on the similarity of the activity to commercial advertising.

American College of Physicians v. United States, 743 F.2d 1570, 1576 (1984).

II. WHEN CONGRESS PASSED UBIT IN 1950 IT MADE IT POSSIBLE FOR A TAX-EXEMPT ORGANIZATION WHICH OPERATED A BUSINESS TO KEEP ITS EXEMPTION

A tax-exempt organization, whether §501(c)(3) or §501(c)(6), must meet three tests established by law and regulations:[6]

1. The *exclusivity* test: A tax-exempt organization must be organized exclusively for the tax-exempt purposes set forth in its charter, or risk loss of its tax-exempt status. Treasury Reg. §1.501(c)(3)-1(c). *Better Business Bureau* v. *United States,* 326 U.S. 279, 282 (1945); *P.L.L. Scholarship Fund* v. *Commissioner,* 82 T.C. 197, 199 (1984).

2. The *incidental but not substantial* test: Where substantial commercial income is mixed with incidental income related to a tax-exempt purpose, tax-exemption can be lost. Treasury Reg. §1.501(c)(3)-1(e). *Scripture Press Foundation* v. *United States,* 285 F.2d 800, 803 (Ct. Cl. 1961), cert. denied, 368 U.S. 985 (1962); *B.S.W. Group, Inc.* v. *Commissioner,* 70 T.C. 352, 357-358 (1978).

3. The *no benefit inuring* test: No part of net earnings of a nonprofit organization can inure to the benefit of any private shareholder or individual without risking loss of tax-exemption. Treas. Reg. §1.501(c)(3)-1(c). *Founding Church of Scientology* v. *United States,* 412 F.2d 1197, 1199 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970); *Unitary Mission Church* v. *Commissioner,* 74 T.C. 507, 513 (1980).

When Congress passed the UBIT, it made it possible for a tax-exempt business to keep its tax exemption by making any unrelated business conducted by that organization taxable. Without UBIT, many organizations, including

[6]26 U.S.C. § 501(c); Treas. Reg. §1.501(c).

professional societies like respondent ACP, could be subject to loss of tax exemption because they would not qualify under the foregoing tests.

Thus, if UBIT did *not* apply to the advertising profits of respondent, ACP could lose its tax exemption because a benefit inures to the individual doctors who are the members and thus the owners of ACP. This inurement can take a variety of forms, including lower dues made possible by using advertising profits to finance ACP's activities. The same situation applies to the activities of all other tax-exempt organizations.

Prior to passage of UBIT, untaxed profits earned from advertising could be used to educate doctors or for any other worthwhile purpose because the test prior to 1950 was the *destination* of income earned by commercial activities, and not the *source* of the income. *See Roche's Beach, Inc.* v. *Commissioner,* 96 F.2d 776, 778 (2d Cir. 1938).

One of the situations which brought about passage of UBIT was ownership by New York University of C.F. Mueller Company, a pasta company. *See C.F. Mueller Co.* v. *Commissioner,* 190 F.2d 120 (3d Cir. 1951). While New York University channeled its macaroni profits into useful educational purposes, including medical education, the profits themselves were derived at the expense of taxpaying competitors of Mueller. New York University is a §501(c)(3) organization, as is respondent ACP. There is no difference between a competitive pasta company contributing its profits to New York University and ACP or the American Medical Association (AMA), for example, competing with taxpaying publishers for advertising and using the profits derived therefrom for purposes no less worthwhile than those of New York University.

The background of UBIT is well explained in *SICO Foundation* v. *United States,* 295 F.2d 924, 926 (Ct.Cl. 1961):

> As Judge Littleton pointed out in the first SICO decision, the law prior to 1951 had been rather clearly established that the destination of an organization's income was more important than the source of its income for purposes of determining exemption from taxation. Experience under this rule, however, showed it to be subject to abuse by those who would subvert its principle into a vehicle for the enjoyment of an unfair competitive advantage in the market place. . . . *The ensuing cry of "unfair competition" fell on sympathetic ears in the 81st Congress which responded with the Revenue Act of 1950.* [Emphasis supplied]

III. THE LEGISLATIVE HISTORY OF THE 1950 UBIT SHOWS THAT THE PUBLISHING BUSINESS IS SUBJECT TO UBIT AND THAT IRS HAS DISCRETION TO DETERMINE WHAT IS UNRELATED BUSINESS INCOME

Enactment of UBIT followed extensive hearings held in 1947-48 by the House Ways and Means Committee. In mentioning various types of business activities conducted by tax-exempt organizations, Chairman Knutson cited publishing *five times:*

> The types of business operations are . . . . *publishing* major newspapers and periodicals, *publishing* books in the field of scholarship and letters, *publishing* a cookbook, selling fire insurance to churches, operating barbershops, operating a dental clinic, *publishing* a magazine on amateur photography, operating jazz con-

> certs for which admissions are charged, operating a *publishing* business, carrying on research and receiving patent royalties in the following fields: (a) chemistry generally, (b) vitamin D concentrates, (c) smoke abatement, (d) paper and pulp industry. [Emphasis supplied]

Proposed Revisions of the Internal Revenue Code: Hearings Before the House Comm. on Ways and Means, 80th Cong., 1st Sess. at 1903 (1947).

The business of publishing newspapers and magazines, of course, includes advertising.

When the question arose on the floor of the House as to which unrelated business activities would be taxed and which would not, there occurred the following exchange between Congressman Dondero and Congressman Lynch:

> Mr. Dondero: With reference to the gentleman's comment that the Bureau of Internal Revenue will determine the question, will not the Bureau of Internal Revenue look to the intent of Congress as to what we intended to tax or not to tax? Perhaps it ought to be clarified in the bill because of the question [regarding taxation of Christian Brothers' wine production] the gentleman from California raised.

To which Mr. Lynch replied:

> It is not possible to define in the bill exactly every case that is going to be covered. *We have drawn it so that there is a certain amount of discretion for the determination of questions of fact as to whether or not a certain matter comes within the purview of the bill.* [Emphasis supplied]

96 Cong. Rec. 9368 (1948).

The discretion to which Congressman Lynch referred is the broad discretion accorded IRS to administer the tax laws of the United States. *United States* v. *Correll,* 389 U.S. 299, 307 (1967); *National Muffler Dealers Association* v. *United States,* 440 U.S. 472, 476-477 (1979). In doing so, IRS must therefore consider the threshold question which passage of the UBIT resolved. That question is answered in identical statements in both the House Ways and Means and Senate Finance Committee reports on the 1950 UBIT legislation as follows:

> The problem at which the tax on unrelated business income is directed is primarily that of unfair competition.

H.R. Rep. No. 2319, 81st Cong., 2d Sess. at 36 (1950); S. Rep. No. 2375, 81st Cong., 2d Sess., at 28 (1950).[7]

In summary, when Congress passed UBIT, it enacted *general* legislation which included publishing and advertising, and granted discretion to IRS to determine where and how the unrelated business tax should apply.

---

[7]In July 1985 in a report entitled *Unfair Competition in the States,* the Business Coalition for Fair Competition (ABP is not a member) at p. 1 states:

> Why does this alarm us? Because too often these commercial nonprofits bring with them into the business world the special privileges they enjoy as nonprofits. These advantages – such as exemption from income, sales and property taxes and much lower postal rates – create a distinct business advantage over their for-profit, taxpaying competitors. The competition becomes inherently unfair.

IV. AFTER CONSIDERING THE VIEWPOINT OF BOTH TAXPAYING AND NON-TAXPAYING ORGANIZATIONS IRS ISSUED REGULATIONS IN 1967 WHICH MADE ADVERTISING IN ALL PERIODICALS PUBLISHED BY TAX-EXEMPT ENTITIES SUBJECT TO UBIT.

In 1960, pursuant to the authority granted to it in 1950, IRS was wrestling with how to apply UBIT to the flourishing and growing advertising businesses of tax-exempt organizations. It was this situation which led ABP to submit a memorandum to IRS questioning the tax status of such periodicals. The 1960 memorandum was later attached as Annex 10 to an ABP 1966 presentation to IRS entitled *How To Make Money in the Advertising Business Without Paying Taxes.* Both of these memoranda are included in the Congressional hearing record on the 1969 Tax Reform bill, H.R. 13270, House Ways & Means Committee, H.R. Rep. No. 91-413, 91st Cong., 1st Sess., at 1168 (1969).

The basis for the 1960 ABP memorandum was the legislative history *prior* to UBIT and the study of applicable judicial decisions and pertinent legislation concerning tax-exemption and the operation of commercial activities by tax-exempt organizations. The 1960 ABP memorandum, just as valid in 1985 as in 1960, concluded:

> Would the situation be greatly different if the tax-exempt organization were to employ a group of salesmen whose services would be available to a member for a fee? If the tax-exempt organization did employ a group of salesmen, it would obviously be promoting nothing but the individual interest of individual members, and it would come directly within the intendment of Regulation §1.501(c)(6)-1. A publication which

> carries advertising is, to all intents and purposes, a group of salesmen, and nothing more.
>
> The way by which this unwarranted and unfair competition may be eliminated should be to require the business league or the scientific organization to pay taxes on its net income received from the sale of advertising space in its publication, or in the alternative to cancel the exemption of the business league or scientific organization on the ground that its activity has exceeded that which is permissible under Section 501 of the Internal Revenue Code.

In November 1963, it was rumored that IRS would soon publish regulations applying UBIT to the advertising revenues earned by journals published by nonprofit organizations. Weithorn and Liles, *Unrelated Business Income Tax: Changes Affecting Journal Advertising Revenues,* 45 TAXES 791 (December 1967). That article stated that Commissioner Mortimer Caplin advised the Ways and Means Committee on June 26, 1964 that IRS was drafting regulations which would make an organization, otherwise exempt, subject to tax on its income from advertising in periodicals. The article said:

> However, delay followed delay (interspersed by rumors of imminent publication) as a result of (1) the strong protests unofficially expressed by numerous organizations which would be affected — generally estimated at about 700 journals with gross annual advertising revenues approximating $110 million, including, for example, *Nation's Business, Journal of the American Medical Association, National Geographic,* and (2) the Service's own technical problem of determining how to allocate journal expenses between (i) editorial

> and other textual content (clearly "related" and thus productive of nontaxable income), and (ii) advertising content (claimed to be "unrelated" and thus productive of taxable income).[8]

Finally, on April 14, 1967, IRS issued its long awaited advertising regulations. Prop. Reg. §1.513-1, 32 Fed. Reg. 5993 (1967). The storm which brewed was so great that when IRS requested comments on the proposed regulations, there were 451 responses.

IRS then held public hearings before a specially constituted panel. There were so many requests to be heard that IRS had to hire the Labor Department auditorium to accommodate all who wished to participate. One hundred and two organizations testified.

The hearing was replete with exhibits. As an example of the kind of unfair competition periodicals like *Forbes* and *Fortune,* (not members of ABP) faced, ABP showed a promotional motion picture prepared and used by the tax-exempt U.S. Chamber of Commerce, publisher of *Nation's Business,* the film entitled "The Committee of One."[9] The movie depicts the extraordinary influence the

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[8]The $110 million figure for 1963 would be a conservative $360 million in 1985, based on the 321% increase in the Consumer Price Index from 1967 to 1985. Bureau of Labor Statistics, *News,* USDL-85-252. Moreover, the number of tax-exempt organizations is now staggering: The May 13, 1985 issue of the *Non-Profit Organization Tax Letter,* cites a recent statement by IRS Commissioner Egger that there are 871,000 exempt organizations, of which 353,000 are charitable organizations and 53,000 are business leagues. (Section 501(c)(6)).

[9]In the movie, the "Committee of One" is the chairman of the board of a corporation. During the hearing, the U.S. Chamber of Commerce opposed the advertising regulations. In 1950 it supported passage of UBIT. But in 1967 the Chamber's testimony would have included advertising in *Nation's Business* as tax-exempt.

Chamber claimed it had upon the country's business leaders as a reason for buying advertising in *Nation's Business.*

On December 12, 1967, IRS and Treasury, after considering the large volume of comments received, issued the final advertising regulations in substantially the same form as had been proposed, effective for all tax years commencing after December 13, 1967. 32 Fed. Reg. 17657.

The events leading up to the issuance of the regulations were as a skirmish compared with the warfare then commenced on Capitol Hill by nonprofit organizations.

V. IN 1968 CONGRESS REJECTED LEGISLATION WHICH WOULD HAVE NULLIFED THE 1967 TREASURY REGULATIONS

The first shot was fired on the floor of the Senate March 27, 1968 when without advance notice Senator Murphy of California introduced an amendment to an excise tax bill, H.R. 15414. This amendment would have exempted advertising in the periodicals of nonprofit organizations from tax if the advertising "is substantially related to the exercise or performance by such organization of its charitable, educational or other purpose or function. . ." .[10] 114 Cong. Rec. 7879 (1968).

The Murphy amendment would have killed the Treasury advertising regulation because everything would be "related": a dentist's chair in a dental society magazine, a pharmaceutical in a medical society periodical, a convention hotel in an association executives' publication, a word processor in a bar association journal, cement in an engi-

[10]This language covered § 501(c)(3), § 501(c)(6), and other § 501(c) organizations.

neering society periodical, chemicals in a chemical society journal, *ad infinitum.*[11]

The Murphy Amendment was introduced on the floor without discussion in the Finance Committee, *Id.* at 7880. The unannounced Murphy rider passed the Senate the day it was introduced. However, when H.R. 15414 went to conference, the Murphy Amendment was deleted. Instead, House Ways and Means Committee Chairman Mills on July 1, 1968 issued Press Release No. 10 which said that his Committee would conduct public hearings within the next several weeks on the advertising regulations if its schedule permitted. As it turned out, the Committee's schedule did not permit hearings to be held before the adjournment of Congress on October 14, 1968.

But before adjournment the opponents of the Treasury advertising regulations were able to have yet another rider[12] tacked on to yet another piece of legislation – this time a soil conservation bill (H.R. 2767). This amendment (section 5 of H.R. 2767) had the ostensible purpose of postponing the effective date of the advertising regulations for one year, if not permanently postponing them.

It was at this point that more deliberative voices in the Senate took hold. Senators Anderson, Morton, Fulbright, and Metcalf announced that they would offer an amendment, No. 955, to the same soil conservation bill, to let the

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[11]Senator Murphy's amendment would have overturned the whole thrust of the source test, as contrasted with the destination test in effect prior to passage of UBIT in 1950, when Congress held that taxability would be determined not by *how* the income was used but *where it came from.*

[12]*See* S. Rep. No. 1497, 90th Cong. 2d Sess. (1968).

Treasury regulations stand until Congress held hearings on the matter in the following year.[13] 114 Cong. Rec. 26667 (1968).

In introducing that amendment on September 12, 1968 with full notice to the Senate, Senator Anderson stated:

> When the matter was before the Senate on March 27, I think we must all admit we knew very little about it. We did not know, for example, that we were opening up a loophole that could cost the general taxpayers $25 million a year, and this at a time when we are raising taxes for everyone else.

Ibid.

Senator Anderson correctly predicted:

> It is my opinion that Congress is going to reaffirm IRS when hearings are held. Certainly we did not bestow the tax-exempt privilege on organizations to become tax sanctuaries competing actively with taxpayers. If we do not reaffirm IRS, we will be giving franchise to nonprofit organizations to go into all sorts of business and we may well be killing the Unrelated Business Tax Congress passed in 1950.

Id. at 26668.

The Anderson Amendment deleting the one-year postponement was debated on the floor of the Senate September 20, 1968. 114 Cong. Rec. 27785-27788:

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[13]The Ways and Means Committee hearings were held February 21, 24-26, 1969. The Senate Finance Committee hearings were held September 11-12, 1969.

Senator Williams of Delaware declared:

> Mr. President, I support the Anderson amendment. I think it is one that should be approved. It amounts to about $25 million a year in revenues. At this particular time, I do not think the Government can afford to lose that amount of revenue. I shall support the amendment.

Id. at 27786.

Senator Pastore specified:

> First of all, I want to say that I am going to support the Senator's amendment. What I think Senators should bear in mind is that we have nothing against these groups who, in many instances, do a fine job and very good work. But we must understand that every time we alleviate, eliminate, or exempt any particular group from paying taxes, we add those taxes onto the rest of our taxpaying society. After all, a certain amount of money must be raised *and all Americans should share the burden equally: otherwise the heavier burden falls upon the remainder of American taxpayers. It is unfair to exempt them and not to exempt others.* [Emphasis supplied]

Ibid.

Senator Metcalf stated:

> . . . Existing law subjects certain tax-exempt organizations to tax on their unrelated business activities. The primary purpose of this tax is to remove the unfair competitive advantage which tax exemption would otherwise confer upon commercial activities of tax-exempt organizations. The need for application of this sound policy to the business activities of exempt organi-

> zations is nowhere clearer than it is in the area of commercial advertising appearing in exempt organization periodicals. The evidence gathered by the Treasury study and hearings graphically demonstrates that tax-exempt organizations compete against taxpaying periodicals for the sale of advertising space with all the tools available to their competitors, plus one — their exemptions.

Id. at 27787.

Senator Dirksen was the only spokesman for postponement. *Id.* at 27786.

The bipartisan Anderson Amendment passed the Senate, and the Treasury advertising regulations were saved.

VI. THE 1969 TAX REFORM ACT RATIFIED THE 1967 TREASURY REGULATIONS, THUS MAKING ALL ADVERTISING INCOME OF ALL TAX-EXEMPT ORGANIZATIONS SUBJECT TO UBIT

The hearings announced by Chairman Mills were held by the Ways and Means Committee February 21, 24-26, 1969.[14]

A. Testimony Of The Opponents Of The Regulations Demonstrates That The Opponents Including Respondent Knew Their Advertising Profits Would Be Subject To UBIT

Of the organizations testifying against the regulation, 24 were §501(c)(3) organizations like respondent ACP and 13 were §501(c)(6) organizations like AMA. All stated they would be subject to the tax.

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[14]Attached hereto as Appendix B are contemporaneous newspaper accounts by the *Washington Post* and *New York Times* of February 26, 1969 which reported the hearings.

One §501(c)(3) witness was Dr. Edward Rosenow, the Executive Director of respondent ACP. The testimony he gave before the Ways and Means Committee in 1969 is essentially the same testimony he gave in this case before Chief Judge Kozinski in the Claims Court in 1983.

Dr. Rosenow's 1969 testimony is highly relevant to the case at bar. He testified:

(1) that the Treasury Department by its regulations had usurped the power of Congress;

(2) that the new Treasury regulations had the effect of "conclusively presuming" that advertising income derived from ACP publications constituted taxable unrelated trade or business income;

(3) that the regulations set up a new test declaring that ACP's advertising was taxable even though it was related to an exempt function.

Dr. Rosenow urged Congress:

> . . . [U]ndo what the Treasury has done . . . by singling out commercial advertising, regardless of whether or not it is substantially related to the carrying out of the exempt functions . . .

The Tax Reform Act of 1969: Hearings on H.R. 13270 Before the House Comm. on Ways and Means, 91st Cong., 1st Sess. at 1113 (1969).

When Dr. Rosenow testified for respondent ACP in 1969, he stated that ACP would have to pay taxes under the Treasury advertising regulations. ACP's 1969 testimony impeaches its position in 1985 in the case at bar. After hearing Dr. Rosenow, Congress voted to give the Treasury regulations the force of law. See pp. 24-26 *infra*.

Another witness was James Low, Executive Vice President of the American Society of Association Executives, a §501(c)(6) organization. ASAE requested that a legal analysis its counsel had prepared be included in the record. *Id.* at 1184. The ASAE legal analysis described Examples 6 and 7 contained in Treasury Regulation §1.513-1(d)(4)(iv) as being "novel" and continued:

> Under the new Regulations, *all* advertising in an organization publication is now taxable (with the dubious exception of college publication advertisements). [Emphasis supplied]

Id. at 1188.

That is a correct statement.[15] Congress agreed with ASAE that all advertising is taxable. It emphasized this fact by giving the Treasury regulations the force of law. (*Infra* at 26). ASAE's 1969 legal memorandum impeaches what ASAE has said to the Court in its amicus brief opposing certiorari.

The American Chemical Society, a §501(c)(3) organization testified:

> If, in the wisdom of the Congress, it should be decided that tax-exempt scientific and educational organizations of the nature of the American Chemical Society should be taxed on their revenues, from any source, we would submit two major items. First, this determination is one for the Congress and the Congress alone, and second should such a determination be made, we are firmly convinced that it would be contrary to law to endeavor to impose such a tax in the fashion in which it has been suggested by the Internal Re-

[15]Treasury Regulation § 1.513-1(d)(4)(iv) (1967), Examples 6 and 7, Appendix A, *infra*, demonstrate this.

venue Service under the regulations to which we object.

Id. at 1128.

Congress answered the American Chemical Society by giving the Treasury regulations the force of law.

The foregoing examples are typical of all testimony delivered to Congress by those non-taxpaying organizations which opposed the advertising regulations. Some, like respondent ACP, amicus ASAE, and AMA in the United States District Court in Chicago, *supra,* still oppose them.

B. Testimony Of Taxpayers In Support Of The 1967 Treasury Regulations

There follows a brief summary of the testimony of witnesses in support of the advertising regulations.

John Babcock, President of ABP, a §501(c)(6) organization, testified:

> *It is our opinion that advertising is a business unrelated to any purpose for which any organization was granted an exemption from the income tax.* Nevertheless, tax exemption has been used by a large number of tax-exempt organizations to conduct just as competitive an advertising business as taxpaying publishers of necessity conduct in order to survive and be able to pay taxes. [Emphasis supplied]

Id. at 1145.

Mr. Babcock brought to the attention of the Committee that beneficial purposes and services are rendered not only by tax-exempt organizations, societies and foundations but by taxpayers as well. *Ibid.*

David McGrath, Senior Vice President of McGraw-Hill

Publications, compared *Chemical and Engineering News,* published by the American Chemical Society with *Chemical Week,* published by McGraw-Hill. *Id.* at 1147.

After testifying that there were over 115 identical advertisements that appeared in contemporaneous issues of both American Chemical Society's *Chemical and Engineering News* and in McGraw-Hill's competing *Chemical Week,* Mr. McGrath stated:

> Now, a question was asked earlier in this testimony about the rates. In the case of *Chemical and Engineering News* [American Chemical Society] their rates are approximately 25 percent higher than *Chemical Week* [McGraw-Hill]. Their circulation is twice as large, so their cost per 1,000 is considerably lower.
>
> If this publication was taxed it is my belief they would have to raise their advertising rates and this might make it a less attractive advertising purchase.
>
> On the other hand, if you believe McGraw-Hill ought not to pay taxes, gentlemen, we could reduce our rates which would help fight the war against inflation.
>
> It would seem logical, gentlemen, in conclusion, and, indeed, fair that in this competitive climate both magazines should have equal treatment from the tax standpoint.

Id. at 1149.

Ralph Hench, publisher of the taxpaying *American Journal of Medicine,* also testified. That publication directly competes today and directly competed in 1969 with respondent ACP's *Annals.* The current President of the company which publishes the *American Journal of*

Medicine, John K. Abely, furnished an affidavit in support of ABP's Amicus Curiae Brief in the court below, reaffirming in 1984 what Mr. Hench said in 1969. That affidavit is attached hereto as Appendix C.

The National Newspaper Association's witness was Richard Cardwell, General Counsel and Manager of the Hoosier State Press Association. He testified:

> The purpose of the so-called unrelated business income tax is really quite simple and basic. Congress determined – and we think rightly – that if tax-exempt organizations engage in business enterprises, in competition with taxpaying private-owned businesses, it would be unfair to grant the tax exempts the advantage of retaining their full profits while their private competitors pay income taxes on comparable profits.

Id. at 1105.

Congress agreed with taxpayers that advertising was a business unrelated to any tax-exempt purpose and gave the IRS regulations the force of law.

C. The Committee Reports Of Both The House And Senate Explicitly Concluded That (1) Advertising Profits Of All Tax-Exempt Organizations Are Subject To UBIT And (2) The 1967 Treasury Regulations Declaring Advertising To Be An Unrelated Trade Or Business Are Valid

After days of testimony, the House Ways and Means Committee stated as follows:

> Finally, the Internal Revenue Service promulgated regulations on December 12, 1967 which clarified the law with respect to the conduct of an unrelated trade or business carried on as a part of an exempt function. *This regulation mainly affected the advertising income of public-*

> *ations such as medical journals. There has been controversy over the validity of these regulations. Your committee wants to make clear that such regulations are valid.* [Emphasis supplied] H.R. Rep. No. 91-413, 91st Cong., 1st Sess., *reprinted in U.S. Code Cong. & Ad. News* 1965 (1967).

The Ways and Means Committee added:

> Explanation of the provision. — Because of the ensuing controversy over this problem your committee has decided to deal with this subject by legislation. In general, it is in agreement with the purpose of the regulations. Your committee believes that a business competing with taxpaying organizations should not be granted an unfair competitive advantage by operating tax free unless the business contributes importantly to the exempt function. *It has concluded that by this standard, advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore it believes that this income should be taxed.* [Emphasis supplied]

Id. at 1695.

The House in passing §513(c) of the Tax Reform Act of 1969 endorsed the Ways and Means Committee's findings and voted to give the Treasury advertising regulations the force of law.

The Senate Finance Committee Report accompanying §513(c) stated:

> Present law. — In December 1967, the Treasury Department promulgated regulations under which the income from advertising and similar activities is treated as *"unrelated business income" even though such advertising for example may appear*

> *in a periodical related to the educational or other exempt purpose of the organization.*
>
> General reasons for change. — The Committee agrees with the House that the regulations reached an appropriate result in specifying that *when an exempt organization carries on an advertising business in competition with other tax-paying businesses, it should pay a tax on the advertising income.* The statutory language [the 1950 Act] on which the regulations are based, however, is sufficiently unclear so that substantial litigation could result from these regulations. For this reason, *the Committee agrees with the House that the regulations, insofar as they apply to advertising and related activities, should be placed in the tax laws.* [Emphasis supplied]

S. Rep. No. 91-552, 91st Cong., 1st Sess., *reprinted in U.S. Code Cong. & Ad. News* 2104 (1969).

Under the heading "Income from advertising, etc., activities (sec. 513 of the Code)," the final conference committee report follows the House report. S. Doc. No. 91-782, 91st Cong., 1st Sess., *reprinted in U.S. Code Cong. & Ad. News* 2406 (1969).

VII. CONGRESS' CLEAR INTENT IN 1969 TO APPLY UBIT TO ALL ADVERTISING WAS FRUSTRATED BY THE ERRONEOUS FEDERAL CIRCUIT DECISION

As this Court has said: "Where Congressional intent is discernible — and here it seems crystal clear — we must give effect to that intent." *Sinclair Refining Co.* v. *Atkinson,* 370 U.S. 195, 215 (1962).

With crystal clear legislative history supporting the Treasury regulations in 1969, 1978 (*supra* at 6), and 1981

through 1984 (*supra* at 6), and with witnesses opposed to the regulations actually stating that they knew they would be taxed if Congress passed §513(c), and with Congress having rejected every attempt to reopen this subject, it is incredible that the Federal Circuit would usurp the taxing power of Congress and in the instant case overturn the trial court.

What IRS did when it published its advertising regulations in 1967 was to establish a rule declaring advertising of tax-exempt organizations like respondent American College of Physicians taxable *per se.* What Congress did in 1969 was (1) declare the IRS advertising regulations valid, H.R. Rep. No. 91-413, 91st Cong., 1st Sess., *reprinted in U.S. Code Cong. & Ad. News* 1695 (1969); (2) declare advertising unrelated to any tax-exempt purpose, *Id.* at 1696; (3) single out the advertising income of medical journals as taxable, *Id.* at 1690; and (4) declare that the regulations should be placed in the tax laws. S. Rep. No. 91-552, 91st Cong., 1st Sess., *reprinted in U.S. Code Cong. & Ad. News* 2104 (1969).

Valid Treasury regulations like Example 7, *supra,* applicable to respondent ACP, should not be disregarded by the courts as happened in the Federal Circuit![16] This Court held in *United States* v. *Correll, supra* at 307, as follows:

> Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the

[16]Even respondent has not challenged Example 7. Its brief opposing certiorari in this case states (p.12):

> While it is true that the Court of Appeals did not discuss the validity *vel non* of Example 7, this silence is perfectly understandable because the College never challenged Example 7.

> Internal Revenue Code. 26 U.S.C. §7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments." Commissioner v Stidger, 386 U.S. 287, 296, 18 L.ed.2d 53, 59, 87 S. Ct. 1065. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner. Because the rule challenged here has not been shown deficient on that score, the Court of Appeals should have sustained its validity.

The vivid and protracted administrative and legislative history delineated herein overwhelmingly proves how far the United States Court of Appeals for the Federal Circuit strayed in this case when it judicially preempted the will of Congress.

Of great consequence will be the inevitable erosion of UBIT itself which will follow if the decision of the Federal Circuit is allowed to stand. If anything, fair competition and the tax revenues of the United States require reinforcement of UBIT to prevent debilitation. That is why ABP's amicus curiae brief supporting the Government petition for certiorari states:

> If ever a case cried out for appellate correction of judicial error, this is that case.

CONCLUSION

WHEREFORE, ABP respectfully requests this Court to reverse the United States Court of Appeals for the Federal Circuit.

Respectfully submitted,

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APPENDIX A

§ 1.513-1(d)(4)(iv)
(iv) Exploitation of exempt functions.

(iv) Exploitation of exempt functions. In certain cases, activities carried on by an organization in the performance of exempt functions may generate good will or other intangibles which are capable of being exploited in commercial endeavors. Where an organization exploits such an intangible in commercial activities, the mere fact that the resultant income depends in part upon an exempt function of the organization does not make it gross income from related trade or business. In such cases, unless the commercial activities themselves contribute importantly to the accomplishment of an exempt purpose, the income which they produce is gross income from the conduct of unrelated trade or business. The application of this subdivision is illustrated in the following examples:

* * * * *

Example (6). Z is an association exempt under section 501(c)(6), formed to advance the interests of a particular profession and drawing its membership from the members of that profession. Z publishes a monthly journal containing articles and other editorial material which contribute importantly to the accomplishment of purposes for which exemption is granted the organization. Income from the sale of subscriptions to members and others in accordance with the organization's exempt purposes, therefore, does not constitute gross income from unrelated trade or business. In connection with the publication of the journal, Z also derives income from the regular sale of space and services for general consumer advertising, including advertising of such products as soft drinks, automobiles, articles

of apparel, and home appliances. Neither the publication of such advertisements nor the performance of services for such commercial advertisers contributes importantly to the accomplishment of any purpose for which exemption is granted. Therefore, notwithstanding the fact that the production of income from advertising utilizes the circulation developed and maintained in performance of exempt functions, such income is gross income from unrelated trade or business.

Example (7). The facts are as described in the preceding example, except that the advertising in Z's journal promotes only products which are within the general area of professional interest of its members. Following a practice common among taxable magazines which publish advertising, Z requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, Z accepts advertising only from those who are willing to pay its prescribed rates. Although continuing education of its members in matters pertaining to their profession is one of the purposes for which Z is granted exemption, the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute; it differs fundamen-

tally from such an activity both in its governing objective and in its method. Accordingly, Z's publication of advertising does not contribute importantly to the accomplishment of its exempt purposes; and the income which it derives from advertising constitutes gross income from unrelated trade or business.

APPENDIX B

WASHINGTON POST FEBRUARY 26, 1969

Exempt Status Provokes Tax Hearing Battle

By Frank C. Porter
Washington Post Staff Writer

The battle over whether advertising income from publications of tax-exempt organizations should be taxed flared anew yesterday as the House Ways and Means Committee continued its hearings on tax reform.

The controversy finds leading commercial trade and professional publications such as Business Week, the American Journal of Medicine and Chemical Week ranged against their non-profit counterparts—Nation's Business, published by the Chamber of Commerce of the United States; the Journal of the American Medical Society, and Chemical & Engineering News, official organ of the American Chemical Society.

Also involved are such historic household standbys as the National Geographic and Boys' Life, a publication of the Boy Scouts of America—both non-profit ventures.

Anticipates Argument

The American free enterprise system cannot exist, said John B. Babcock, president of American Business Press, Inc., "if we have one business paying an income tax on its profits and a competitor paying no income tax on its profits."

But "to say these magazines compete in the market place is a misrepresentation," James P. Low, executive vice president of the American Society of Association Executives, told the Committee.

Babcock had already anticipated this argument, however, by having the spacious hearing room darkened and screening a hard-sell promotion film used by Nation's Business. The film wooed potential advertisers with self-assured claims that their message would reach far more of the Nation's business decision-makers in Nation's Business than in Business Week or Fortune.

Babcock's organization represents McGraw-Hill, publisher of Business Week, as well as other large trade publication chains.

Tried for Amendment

Under law tax-exempt organizations are required to

pay taxes on "unrelated" business income. Until late 1967 advertising revenues from such periodicals as Nation's Business and the National Geographic were considered "related" and consequently escaped taxation.

But then the Internal Revenue Service ruled that such income was indeed "unrelated" and the non-profit publications have had to pay taxes, not on their total income, but on advertising revenues.

The tax-exempt groups tried in vain last summer to push through an amendment to the Revenue Act of 1968 that would have overturned the IRS ruling.

Now Ways and Means has placed the question on its agenda for comprehensive reform of the Nation's entire tax system.

Ruling Called 'Capricious'

Babcock and others yesterday argued that advertising in itself is unrelated to the purposes of such groups as the AMA, Boy Scouts and Chamber of Commerce.

Their opponents claimed the IRS ruling was capricious, overrode the intent of Congress and was inconsistent in splitting an integrated operation into taxable advertising and an untaxed editorial operation.

They further argued that the content of their advertising is indeed related to their exempt purposes and that the advertising revenues, undiluted by taxes, are necessary to carry on their main activities—scouting, for example.

Babcock said that a number of members of the American Business Press, which represents some 500 organizations, have resigned from the Chamber of Commerce in protest against its position of "opposing for itself the free enterprise principles it espouses for others."

NEW YORK TIMES FEBRUARY 26, 1969

Tax-Exempt Groups Score U.S. Ruling

WASHINGTON, Feb. 25 (UPI) —The House Ways and Means Committee was asked today to help overturn an Internal Revenue Service ruling that tax-exempt organizations must pay taxes on income from advertisements in their publications.

James P. Low, representing 2,900 professional tax-exempt associations that publish trade magazines, said that the income, which yielded "little net revenue," was essential to cover costs of publication as a service to subscribers.

But representatives of commercial magazine publishers defended the ruling and criticized such groups as the American Medical Association and the Chamber of Commerce of the United States for failing to practice what they preached about free enterprise.

Rree enterprise, said John B. Babcock, "cannot exist if we have one business paying an income tax on its profits and a competitor paying no income tax on its profits."

Mr. Babcock is president of the American Business Press, Inc., representing 500 commercial business publications. He said that some of his member publishers had quit the Chamber of Commerce "because of the position it has taken in opposing for itself the free enterprise principles it espouses for others."

Ruling Outlined

The Revenue Service ruled in December, 1967, that advertising income from publications of tax-exempt organizations was "unrelated" to the educational, scientific or charitable purposes for which the tax immunity was granted and therefore must be taxed.

An effort to overturn the ruling failed in Congress last year. The committee is now investigating possible abuses of tax laws.

Mr. Babcock showed the committee a film produced by the Chamber encouraging advertising in its magazine, Nation's Business. He said that tax-exempt groups competed just as vigorously for advertising as commercial, taxpaying publishers, who must do so to survive.

Ralph W. Hench Jr., representing publishers of commercial magazines, said that the medical association, with a net worth of more than $19-million in 1967, paid advertising agencies $2.2-million in commissions in 1966 for business placed in its journals.

APPENDIX C

AFFIDAVIT OF JOHN K. ABELY IN SUPPORT OF MOTION OF AMERICAN BUSINESS PRESS FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF SUGGESTION OF UNITED STATES FOR REHEARING EN BANC

IN THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

APPEAL NO. 84-715

THE AMERICAN COLLEGE OF PHYSICIANS
Appellant

v.

THE UNITED STATES
Appellee

STATE OF NEW YORK)
) SS
COUNTY OF NEW YORK)

I, John K. Abely, being duly sworn, depose and say:

1. That I am President of Technical Publishing Co., an independent division of the Dun and Bradstreet Corporation. I have been professionally engaged in publishing for 27 years.

2. Technical publishes 21 medical, technical and business periodicals. These include the *American Journal*

of Cardiology, the *American Journal of Medicine*, the *American Journal of Surgery* and *Cutis* (a journal publishing clinical articles in dermatology), which comprise the Yorke Medical Group of Technical Publishing. All of our publications are published for-profit and are tax-paying journals.

3. Other periodicals published by Technical include *Dun's Business Monthly*, *Datamation*, *Plant Engineering* and *Solid State Technology And Research and Development*.

4. I have read the decision of the United States Court of Appeals for the Federal Circuit in *American College of Physicians* v. *United States*, slip op. no. 84-715. I am shocked by the conclusion in the Court's Opinion that the commercial advertising in the *Annals of Internal Medicine* should be tax-exempt. This decision, in my opinion, gives publishers of non-profit journals, which compete with tax-paying periodicals, a green light to again engage in unfair competition with us and other publishers.

5. At Technical, and I know I reflect the view of the 500 specialized tax-paying periodicals which belong to the American Business Press, we thought the issue of the unrelated business tax had been put to rest in 1969 when Congress specifically applied the unrelated business tax to advertising. Now to my amazement, the Court has said our competitors do not have to pay taxes on their advertising profits, because the advertising in *Annals* is allegedly related to the tax-exempt function of the owners of *Annals*. (slip op. at 18).

The same type of advertising appearing in *Annals* appears in our *American Journal of Medicine* and other medical periodicals. Each of our four medical journals

limits the type of advertising in the same manner as *Annals*. Each of our journals has a distinguished board of doctors who provide peer review as does *Annals*. From time to time, the same doctors who provide peer review for *Annals*, perform the same function for our medical journals.

The advertisements carried both in *Annals* and our journals do not announce new developments alone, but are printed month after month, as is the case with most commercial advertising, in order to make it effective.

Advertisements are aggressively solicited by salesmen representing the American College of Physicians. These solicitations are made to pharmaceutical manufacturers and to their advertising agencies. Out on the street the battle is for a share of an advertiser's budget: there may not be enough to place the same advertisement in both *Annals* and one of our journals. Advertisements published in *Annals* are sold at competitive rates in *Annals* and in our journals: the difference is that if this decision is upheld, *Annals* will not have to pay taxes on its advertising profits, but we will. This is unfair competition.

6. On February 25, 1969, when Congress held hearings on the unrelated business tax, Congress was particularly concerned with application of the tax to advertising in nonprofit journals like *Annals*. Ralph Hench, then President of our medical publications, testified before the House Ways and Means Committee in support of the IRS regulations of 1967 which applied the unrelated business tax to advertising profits of nonprofit journals like *Annals*. He emphasized the unfair competition that his competitors like the *AMA Journal* and *Annals* were able to mount against him by virtue of their tax exemption.

7. I note that Dr. Edward Rosenow, Executive Director of *Annals*, appeared in the same hearing as Mr. Hench. And I further note that Congress ruled as Mr. Hench and others thought and not as Appellant and other would-be tax avoiders urged.

Nothing has happened in the last 15 years in the world of medical publishing to make the testimony of Mr. Hench any less relevant: if anything, there has been a proliferation of medical journals – some nonprofit, some for-profit. All of them are fiercely battling in a competitive marketplace for the medical advertising dollar. There should be no unfair tax advantage to any.

8. The reason why pharmaceutical companies advertise in medical journals is because they want to sell their products to readers who are in a position to buy their products. This is true of *Annals,* of our own journals and of all other journals that carry advertising. Let's face it: The purpose of advertising is to sell products. If *Annals* does not agree with this, it has a clear option: Let it provide its advertising without charge. Then there would be no income and therefore no tax.

9. I attach as Attachment 1 an advertisement *Annals* bought and paid for in *Medical Advertising News.* The purpose of this advertisement is to solicit additional advertising for *Annals.* Appropriately, *Annals'* advertisement is entitled "The Bottom Line," a financial term, not a term usually associated with nonprofit organizations. The advertisement gives both the names and telephone numbers of *Annals'* "sales representatives." It strikes me as anomalous that an organization exempt from Federal taxation has "sales representatives."

10. *Annals* has a sister tabloid publication published by the same nonprofit organization. Its title is *"The*

Observer." *Annals* conducts a joint advertising campaign with *The Observer.* Attachment 2 is an advertisement urging advertisers to advertise in both periodicals. I note that the advertisement states "Plan on scheduling *ACP Observer* and *Annals* to cash in on the clout of the Stellar Journal/Tabloid Team." The emphasis is on "cash[ing] in." How is "cashing in on the clout" of any tax-exempt organization related to any tax-exempt purpose?

11. Back issues of *Annals,* upon request, are bound into volumes. When so bound, the advertising pages are deleted because, according to *Annals,* these pages are "extraneous material." (*Annals,* March 1983, p. I-117). That *Annals* follows this practice is further proof that the true purpose of *Annals'* advertising is to make money for the doctors who make up the ownership of the periodical.

12. If the three-judge panel's decision in this proceeding is upheld, its effects will be widespread, going far beyond the medical publishing field. All types of nonprofit journals will claim their advertising is "substantially related" to their tax-exempt purpose. We heard all these arguments in 1969 when we testified before Congress. Congress turned those arguments down, but unfortunately, the three-judge panel now has opened up a loophole for tax-exempt advertising and unfair competition. Trade associations, universities, professional societies and others which publish journals will even more aggressively market their journals to advertisers to take competitive advantage of the Court's Opinion.

In the meantime, journals like our *American Journal of Medicine* which pays taxes, will have to compete for the same advertising dollars as the *Annals of Internal Medicine.*

/s/ John K. Abely
John K. Abely

Sworn and subscribed before me this 29 day of October, 1984.

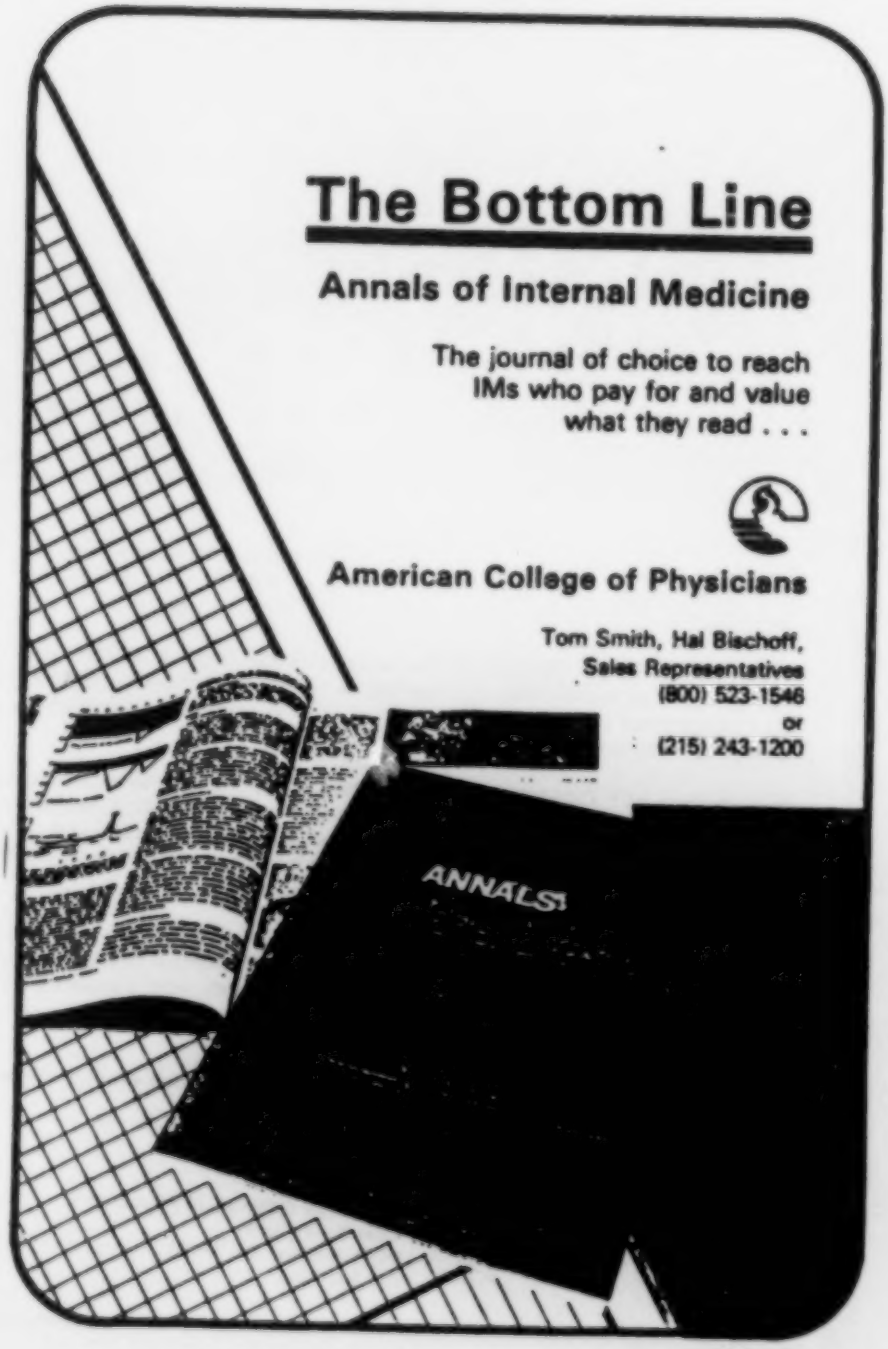
My commission expires

STATE OF NEW YORK
NEW YORK COUNTY

JOSEPH J. ZACCARIA, Notary Public
State of New York, 31-437550
Qualified in New York County
Commission Expires March 30, 1985

/s/ Joseph J. Zaccaria
Notary Public

Attachment No. 1



[Reproduced from *Medical Advertising News*, April 1984]

Attachment No. 2

You don't need a telescope to spot the newest star in the IM universe. It's ACP OBSERVER, teammate of the IM superstar, ANNALS OF INTERNAL MEDICINE.

In just one year ACP OBSERVER has added editorial pages and editorial color . . . has switched to better stock . . . has added several high-interest editorial features. And where once there were only a modest few "A"-size ads, now 4-color 2, 4 and 6-page spreads are showcased in every issue!

By including ACP OBSERVER on your schedule, you reach the entire membership of the American College of Physicians. Use this lively, interesting, and informative tabloid to reach the IM when he's relaxed and receptive . . . and eager to know the latest news from Washington, or the pros and cons of medicine's newest controversy.

Plan on scheduling ACP OBSERVER and ANNALS to cash in on the clout of the stellar Journal/Tabloid Team. You reach every ACP member twice a month, plus 46,000 non-members once a month when you use both. Add frequency discounts for the best buy in IM coverage.

For more information contact:

Tom Smith
Hal Bischoff
American College of Physicians
4200 Pine Street
Philadelphia, PA 19104
215 243-1200

ANNALS of Internal Medicine

OBSERVER

Supreme Court, U.S.
FILED
NOV 14 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1737

IN THE

Supreme Court of the United States

OCTOBER TERM 1984

UNITED STATES OF AMERICA,

Petitioner,

v.

AMERICAN COLLEGE OF PHYSICIANS,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF FOR AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT, AMERICAN COLLEGE OF PHYSICIANS

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QUESTION PRESENTED

Whether the income derived by a tax-exempt organization from the placement of advertising in the organization's publications is subject to taxation where such advertising, although it may be partly commercial in nature, contributes importantly to the accomplishment of the organization's tax-exempt purposes.

No. 84-1737

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OCTOBER TERM, 1984

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BRIEF FOR AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT, AMERICAN COLLEGE OF PHYSICIANS

PRELIMINARY STATEMENT

The American Society of Association Executives ("ASAE") submits this brief *amicus curiae* in support of the Respondent, American College of Physicians. All parties to this suit have given ASAE written consent to the filing of this brief. Copies of such consents have been filed with the Clerk of this Court.

INTEREST OF AMICUS CURIAE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

The American Society of Association Executives (ASAE) is a non-profit organization exempt from taxation under Section 501(c)(6) of the Internal Revenue Code. ASAE exists to promote the art and science of association management and to educate its members and the general public in the advancement,

improvement and uses of voluntary associations. The membership of ASAE is comprised primarily of full-time staff personnel engaged in the management of trade, professional, technical, educational, philanthropic or similar type organizations. ASAE has over thirteen thousand active members. ASAE has long been recognized as a leading speaker and advocate on association issues, particularly where, as in the present case, the ability of associations to function as educational and public spirited organizations is at stake.

A number of ASAE's 13,000 members are actively involved in managing associations that publish educational journals and many of those journals accept educational advertisements such as those which the Federal Circuit considered in the case below. ASAE also publishes several magazines that accept educational advertisements. ASAE's monthly publication, *Association Management*, is read by thousands of association executives and contains numerous articles and advertisements on good management techniques, effective tradeshow strategies, membership needs, changes within various professions, disciplines and industry groups, as well as relevant news on legal events concerning non-profit organizations.

Many association executives have been forced to forego the opportunity to assist their members in providing the most expansive and broad reaching educational information because of the restrictive interpretation of the non-profit advertising regulations used by the Internal Revenue Service. This interpretation has often been a factor in the decisions of many associations not to publish advertisements in their magazines and journals, even where it is clear that such advertisements would assist members in making intelligent choices and being more aware of issues and decisions with which they must deal in their work.

ASAE believes that its experience as a non-profit organization leader and its insight into the issues on certiorari will prove helpful in this case.

SUMMARY OF ARGUMENT

Section 513 of the Internal Revenue Code provides a definitional framework whereby a distinction can be drawn between those trades or businesses conducted by nonprofit organizations which are substantially related to the organization's exempt purposes and, therefore, not subject to taxation, and those trades or businesses which are not substantially related and, therefore, are subject to taxation. Contrary to the government's contention, Section 513(c) does not set forth a per se rule that particular trades or businesses must be deemed "unrelated." Rather, Section 513(c) establishes a "fragmentation principle" under which a particular activity will not automatically be deemed to be "related" merely because it is carried on within the context of an overall activity which is related to exempt purposes.

Section 513 is clear on its face and its plain meaning is that the determination as to whether a given trade or business is or is not substantially related to exempt purposes is a determination which must be made based on the facts and circumstances of each case. Even if resort is had to the legislative history underlying the amendment of Section 513(c) in 1969, that legislative history does not support the proposition that Congress intended to make it clear that *all* advertising appearing in journals published by tax-exempt organizations is subject to taxation.

The "commercial" nature of an activity is not dispositive of the taxability of that activity under Section 513. For an activity to be subject to the unrelated business income tax, there must be a determination that the activity is (1) a trade or business, (2) regularly carried on, (3) which is not substantially related to the exempt purposes of the organization conducting the activity. The "commercial" nature of an activity is important in determining whether the activity is a "trade or business" but is not a controlling factor in determining whether the activity is substantially related to exempt purposes.

Example 7 under the Internal Revenue Service regulations does not establish a per se rule that all advertising appearing in an exempt organization's publications is subject to taxation and

Example 7 is inapplicable to the facts in the case at bar. Example 7 deals with "ordinary commercial advertising" which merely proposes a commercial transaction, whereas the advertising in the instant case has a significant informational and educational component which differentiates it from the advertising considered in Example 7. Example 7 does not mandate the taxation of advertising if the educational function of such advertising contributes importantly to exempt purposes.

Affirmance of the decision below will impose no administrative burdens which do not already exist in regard to the unrelated business income tax. The Internal Revenue Service long has recognized that the peculiarities of the unrelated business income tax frequently require the examinination of an exempt organization's sales activities on a category-by-category basis. A requirement that the Service examine advertising on a similar basis is fully in conformity with the law and regulations.

ARGUMENTS

I. SECTION 513 DOES NOT CREATE A PER SE RULE THAT ADVERTISING INCOME IS TAXABLE

A. Section 513(a) Of The Internal Revenue Code Does Not Deem All Trades Or Businesses To Be Unrelated To The Exempt Purposes Of Nonprofit Organizations.

Section 513(a) of the Internal Revenue Code states as follows:

> (a) *General Rule.* — The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by Section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or per-

formance of any purpose or function described in section 501(c)(3)), except that such term does not include any trade or business. —

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 510(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Section 513 of the Internal Revenue Code is definitional in nature and has two applications. The first application is to trades or businesses the conduct of which are not substantially related to the exercise or performance by an organization of its charitable, educational, or other purposes or functions constituting the basis for its exemption. The second application of Section 513 is to those activities which *are* substantially related to the exempt functions of an organization.

A plain reading of Section 513(a) reveals that the express intent of this section is to allow certain trades or businesses to be considered related to the purposes of an exempt organization *regardless* of the type of commercial activity involved. The application of Section 513(a) cannot therefore be disputed: if an organization conducts a trade or business related to the exempt purposes of the organization, no matter the commercial character

of or income from the activity, such trade or business will not be a taxable activity. Because of Section 513's plain meaning it is obvious that in enacting Section 513, Congress did not mean to delineate any specific type of trade or business as being an "unrelated trade or business" in all cases. Rather, it meant only to tax the income of trades or businesses which are unrelated to an organization's exempt purposes by virtue of their failure to meet the requirements under Section 513(a). Ultimately, therefore, a fact question arises in each case as to whether or not a trade or business of an organization meets the substantially related definition contained in Section 513(a).

Section 513(a) also contains three subparagraphs which allow for certain activities to be considered exempt trades or businesses. All that is required for one of these three exceptions to apply is that: (1) substantially all the work in carrying on such trade or business be performed for the organization without compensation; (2) the activity be carried on for the convenience of members, students, patients, officers, or employees; (3) merchandise be sold which has been donated to an organization as gifts. These three subparagraphs of Section 513(a) are further evidence that Congress intended to create numerous exceptions for the taxation of certain commercially oriented activities carried on by exempt organizations. Nowhere in Section 513(a) is this principle controverted.

B. Section 513(c) Provides A More Definite Definition Of The Term "Trade Or Business" But Describes No Blanket Rule Regarding Any One "Unrelated" Trade Or Business

Section 513(c) of the Internal Revenue Code states as follows:

> (c) *Advertising, Etc., Activities.* — For purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger com-

> plex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

In enacting Section 513(c) of the Code, Congress essentially codified what has become known as the "fragmentation approach" employed by the Internal Revenue Service in determining the taxable portion of income which is derived by a tax-exempt organization when it engages in an unrelated business activity as a part of an overall activity which is in furtherance of exempt purposes. This approach is used where a publication has both tax-exempt and non-exempt features. Thus, the editorial content of a tax-exempt publication would be an exempt function, but the advertising in the publication (provided it is not substantially related to the exempt organization's purposes) could be a taxable activity. Congress did not, by the terms of Section 513(c), intend to designate any one activity, such as advertising, as an unrelated trade or business. Rather, Section 513(c) serves only to allow for a closer examination of certain activities undertaken by an exempt organization. One examination is for editorial content and another examination is for any trade or business which might be unrelated to the exempt purposes of the organization. Nowhere in Section 513(c) is there a requirement that all advertising income of a tax-exempt publication be considered a trade or business unrelated to an organization's exempt purposes.

C. The Meaning of Section 513(a) And Of Section 513(c) Is Plain From A Reading Of The Statute And An Examination Of The Legislative History Concerning These Sections Is Unwarranted.

The Federal Circuit in the decision below undertook an examination of Section 513(a) and Section 513(c) to determine whether or not the advertising income realized by the American College of Physicians was unrelated to that organization's exempt purposes. This the Court was required to do by the plain meaning of Section 513(a) and of Section 513(c). The Federal Circuit found no need to resort to the legislative history of the statute, as

has the counsel for the Government, because the meaning of the statute and, for that matter, the regulations thereunder, is plain and clear. The United States Supreme Court has held in many cases that

> the meaning of the statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, . . . the sole function of the Court is to enforce it according to its terms.

Caminetti v. *United States*, 242 U.S. 470 (1917).

Thus, where the language of a statute is

> plain and admits of no more than one meaning the duty of interpretation does not arise and the rules which are to aid doubtful meanings need no discussion.

Id.

The result reached below is entirely consistent with the plain meaning of Section 513(a) and of Section 513(c). The history of the application of Section 513(a) and Section 513(c) as to advertising income is a history of factual disputes between the government and private parties as to whether or not certain advertising activities are substantially related to an organization's exempt purposes. The factual nature of the application of Sections 513(a) and 513(c) was recognized by the United States Court of Claims in *American College of Physicians* v. *United States*, 530 F.2d 930 (Ct. Cl. 1976), where it noted that the educational value of advertisements appearing in the *Annals of Internal Medicine* was an "essentially factual dispute." 530 F.2d at 930. Because it is clear that the statute requires a facts and circumstances test to determine whether an activity such as advertising is to be considered related to an organization's exempt purposes, the government's reliance on the legislative history of Section 513(c) is unwarranted and invalid. In *United States* v. *Turkette*, 452 U.S. 576 (1981), this Court held that if statutory language is unambiguous, in the absence of a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive. The contrary legislative intent is missing in this case because

had Congress intended to create in Section 513(c) a blanket rule regarding advertising income, it would have done so. Sections 513(a) and (c) cannot be any more unambiguous than they are.

The Federal Circuit examined the facts surrounding the advertising activities of the American College of Physicians as it was required to do under Section 513(a). The Federal Circuit was aware of the application of Section 513(c) but concluded, rightly so, that Section 513(c) does not automatically label as an "unrelated trade or business" every advertising activity of an association. Section 513(c) does not say this and any conclusion that it does so is unwarranted. In enacting Section 513(c), Congress expressly allowed for the conclusion reached by the Federal Circuit because it in no way altered Section 513(a) nor did it state in Section 513(c) that all advertising activities are to be considered unrelated trades or businesses. Section 513(c), as it indicates on its face, does no more than provide a guide as to when an activity will be considered a trade or business. It does not diminish the "substantially related" exceptions contained in Section 513(a).

D. Section 513 Of The Internal Revenue Code Must Be Considered As A Whole And Not Interpreted Piecemeal

The approach by the government in this case is one which could detach Section 513(c) from the rest of the statute (i.e., from Section 513(a)) and read into Section 513(c) a number of unsupported conclusions. One such unsupported conclusion is that the statute was intended to operate as a "per se" rule with regard to the unrelated trade or business character of advertising activities by nonprofit organizations. It has long been a rule of statutory construction that each part or section of a statute should be construed in connection with every other part or section so as to produce a harmonious whole. *In Re Public Bank of New York*, 278 U.S. 555 (1928). It is not proper to confine interpretation to the one section to be construed. *Harrison* v. *Northern Trust Company*, 317 U.S. 476 (1943). It is, therefore, an incorrect assumption on the part of the government that the proper way to construe Section 513(c) is in an isolated fashion without any

reference to the exceptions contained in Section 513(a). Nothing in Section 513(c) demands, at least on the face of the statute itself, that this section be construed alone. The decision of the Federal Circuit below is within the letter and spirit of the entire Section 513 of the Internal Revenue Code when it concludes that

> Section 513(a) expressly requires that, although considered a separate trade or business, the conduct of that advertising must be evaluated to determine whether it is not substantially related to an exempt purpose or function of the organization and to determine whether the conduct of the trade or business is not primarily for the convenience of the organization's members, before that income is taxable.

743 F.2d 1570 at 1575. Certainly, a reading of Section 513(c) does not lead one to conclude that if an advertising activity is to be considered a trade or business under Section 513(c) one may not at the same time inquire under Section 513(a) as to whether or not the activity is nonetheless substantially related to the exempt purposes of the organization.

If Section 513(c) is properly considered as an amendment to Section 513 of the Code, the new provision should be presumed in accordance with the legislative policy embodied in the prior statute. *Allen* v. *Grand Central Aircraft Company*, 347 U.S. 535 (1954). Thus, the two statutes should be construed together. *Sanford* v. *Commissioner of Internal Revenue*, 308 U.S. 39 (1939). If the two statutes are construed together, then the legislative policy embodied in the plain language of the statute becomes clear: An examination is required of all trades or businesses to determine whether or not they are substantially related to an organization's exempt purposes. If such activities are not so related, they will result in unrelated business taxable income. If they are so related, they will not result in unrelated business taxable income. The statute as well as the regulations, require this type of analysis.

E. Section 513(c) Does Not Deal With The Subject Of Advertising And The Title Of Section 513(c) Does Not Support The Conclusion That All Advertising Activity Amounts To An Unrelated Trade Or Business

Section 513(c) of the Internal Revenue Code is entitled "Advertising, Etc., Activities." The activity of advertising is mentioned only in the title and does not appear anywhere in Section 513(c) itself. It is therefore clear that the section was actually meant to apply to a number of activities and not just to advertising. It cannot be argued, therefore, that Section 513(c) was enacted only to deal with advertising as either a related or unrelated trade or business. The government cannot rely simply on the title of this section to argue that advertising is to be considered an unrelated trade or business in all cases. *United States* v. *Minker*, 350 U.S. 179 (1956), for example, holds that although the title is part of a statute, it may not be used as a means of creating an ambiguity when the body of the act itself is clear. *See also*, *Brotherhood of Railroad Trainmen* v. *Baltimore & Ohio Railroad Company*, 331 U.S. 519 (1947), holding that the title of a statute or the *heading of a section* are of use for interpretive purposes only when they shed light on some ambiguous word or phrase, and cannot limit the plain meaning of the text. If the government were allowed to prevail on its claim that Section 513(c) operates as a per se rule on the disposition of all advertising income, then it would be adding something to the statute based only upon the title of Section 513(c). The addition urged by the government clearly has no place in Section 513, as can be seen by the language in Section 513(a). As the Federal Circuit held in the decision below, even if Congress did intend to tax all advertising revenues of all journals of exempt organizations through Section 513(c),

> it failed to carry that alleged intent forward into the statute with language appropriate to affect that result.

743 F.2d at 1575. The title of Section 513(c) suggests only that advertising is one of the activities that does not lose its identity as a trade or business simply because it is part of a larger exempt

activity. To expand Section 513's meaning beyond this would be to go outside the plain meaning of the statute.

F. Congress Has Failed To Adopt An Express Rule On The Advertising Income Of Exempt Organizations

Congress had the chance in 1969 to enact a provision which would have taxed all advertising income of exempt organizations. Congress did not do this, however, but instead chose only to adopt the Treasury Department regulation which acted to fragment the analysis of income from non-profit publications. Nothing in what Congress enacted in 1969 requires anything more than the examination of an advertising activity to see if it meets the tests set out in Section 513(a). While this Court has been reluctant to draw certain conclusions from the failure of Congress to act, it is nevertheless, irrelevant for the government to urge the court to give a reading to statutory language that Congress has considered and rejected. *Pacific Gas and Electric* v. *State Energy Resources Conservation and Development Commission*, 461 U.S. 190, 220 (1983). ASAE urges that this Court need not examine the legislative history of Section 513(c) because of the plain meaning and lack of ambiguity in the entire Section 513. Nevertheless, if the court does investigate the legislative history of Section 513(c), it will see that Congress was given ample opportunity to enact just the type of statute which the government now claims exists in current Section 513(c) — i.e., one which would conclusively presume all income from advertising activities by tax-exempt organizations to be taxable. This Congress refused to do. The legislative history is replete with instances where advertising activities could have been dealt with in a more detailed manner than is currently the case. For example, at one point during the legislative process, the Senate Finance Committee attempted to include specific language regarding advertising within Section 513(c). Although this specific language would not have adopted the per se rule which the government now urges, it would have dealt with advertising in a more specific vein. The report of the Senate Finance Committee, November 21, 1969, states:

> The Committee amendments approve the intent of the House provision, but restructure the language of the

> provision so that it will apply only in the case of advertising and certain other profit-making activities carried on within a larger aggregate of activities . . .

S. Rep. No.91-552, 91st Cong., 1st Sess. 75 (1969). The language which the Senate Finance Committee wanted to include in Section 513(c) is as follows:

> (c) *Advertising, Etc., Activities.* — For purposes of this Section the term 'trade or business' includes the following activities carried on for the production of income:
>
> (1) the publication of advertising in any magazine, newspaper, periodical, or other publication, for the dissemination of advertising by radio or television broadcasts, . . .

Even if the above provision drafted by the Senate Finance Committee had been included within Section 513(c), it still would not have amounted to a per se rule stating that all advertising income of tax-exempt organizations shall conclusively be presumed to be unrelated trade or business income. Rather, the language suggested by the Senate Finance Committee would only have indicated that advertising is one of the activities which does not lose its character as a trade or business merely because it is carried on in conjunction with the publication of a tax-exempt magazine or newsletter. The test in Section 513(a), that of substantiality, would still apply.

This means that, though Congress had the chance to pass a per se rule which would have definitely characterized all advertising income as unrelated trade or business income, it failed to do so and indeed did not want to do so. The closest Congress came to a rule on advertising and advertising alone came from an attempt by the Senate Finance Committee to define the parameters of Section 513(c) so as to specifically apply to advertising and a few other select activities. As we have seen, however, even that attempt would not have engendered the result now urged by the government — that of a per se rule casting all advertising income as unrelated trade or business income.

Because of the Congressional action, or, perhaps inaction, with regard to this issue, a court would be well within its rights in interpreting Section 513 to mean that Section 513(a) allows for defining advertising income as "related" income if it is from an activity that is substantially related to the exempt purposes of an organization. There is simply no way for the government to refute this fact.

G. The Government May Not Reply On The Views Of The Opponents Of Section 513(c)

Again, ASAE stresses that legislative history is not relevant and should not be decisive in this case. However, it cannot be ignored that Congress failed to enact the law which the government claims has been enacted in Section 513(c) and, though Congress conducted hearings on this law and heard many witnesses, the law which emerged from the legislative process does not embody the recommendations of many of the witnesses at the legislative hearings. It may thus be inferred that Congress has chosen to reject the position of many of the witnesses at those hearings. See, *Helvering* v. *Wood*, 309 U.S. 344 (1940). In *Helvering* this Court held that where Congress, in enacting a law, has acted specifically only on one of two recommendations, this is indicative that the language of the specific provision must be taken at its face value only. See also, *Western Union Telegraph Company* v. *Lynn Root*, 323 U.S. 490 (1945), holding that to translate a statute, by a process of interpretation, into an equivalent of bills rejected by Congress is beyond the fair range of interpretation.

There is another reason why the legislative history argument advanced by the government is suspect. In its brief the government relies heavily upon testimony of witnesses who opposed the enactment of Section 513(c). Brief of United States at 19-20. The government's discussion of the position of the opponents of the Treasury regulation and any law codifying the Treasury regulation is not entitled to any weight in considering the Congressional intent underlying Section 513(c). Statements by the opponents of a bill are not the most reliable indications of Congressional intent. See, *Bryant* v. *Yellen*, 447 U.S. 352 (1980). ASAE believes, in

any case, that the legislative history of Section 513, as it pertains to the government's argument is irrelevant since Section 513(c) does not do what the government claims it does or what some of the witnesses at the legislative hearings wanted it to do. It does not create a blanket definition requiring that all advertising income from exempt organization publications be considered unrelated trade or business income.[1]

II. THE COMMERCIAL NATURE OF AN ACTIVITY IS NOT DETERMINATIVE OF THE TAXABILITY OF THAT ACTIVITY UNDER SECTION 513

In essence, the government contends that if an activity is *commercial* in nature, then the activity cannot be related to exempt purposes so as to avoid the unrelated business income tax. This contention conflicts with the statute, the regulations and established case law. The *commercial* nature of an activity is relevant to the inquiry as to whether the activity constitutes a "trade or business" but it is not dispositive as to the taxability of the activity.

In determining whether an activity engaged in by a tax-exempt organization is subject to the unrelated business income tax, Treasury Regulation Section 1.513-1(a) sets forth three elements which must be established: the activity must be (1) a trade or business within the meaning of section 162 of the Internal

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[1] Nor does the government's reference to the statements of many commentators on the Internal Revenue Service Regulations and the 1969 legislation provide support for the government's position. While the goverment contends that these commentators opined that the regulations and the 1969 amendment to Section 513(c) created a rule that all advertising income would be taxable, close analysis of the articles referenced by the government demonstrates that such was not the thrust of the commentators' analysis. Rather, those articles focused on the unique theory of the "fragmentation principle" (and the computational problems caused thereby) which posited that one business activity could be fractionalized into taxable and non-taxable components. The articles focus on the difficulty of applying the "fragmentation principle" and, in using advertising in an exempt publication as an example, *assume* that the advertising will be taxable in order to examine the computational acrobatics required to differentiate taxable and non-taxable income where a distinct activity generates both types of income.

Revenue Code; (2) which is regularly carried on; and (3) which is not substantially related to the exempt function of the organization. This three-part test has been adopted and recognized by the courts and was recognized by the court below. See, *Professional Insurance Agents of Michigan* v. *Commissioner*, 726 F.2d 1097, 1102 (6th Cir. 1984); *Louisiana Credit Union League* v. *United States*, 693 F.2d 525, 531 (5th Cir. 1982); *Hi-Plains Hospital* v. *United States*, 670 F.2d 528, 530 (5th Cir. 1982).

As to the first test — whether or not an activity constitutes a "trade or business" — the courts have established two criteria. The activity will constitute a "trade or business" where it is engaged in with a "profit motive," *Professional Insurance Agents, supra; Louisiana Credit Union League, supra,* and/or where the activity is conducted in a "competitive, commercial manner." *American Bar Endowment* v. *United States*, 761 F.2d 1573 (Fed. Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3272 (U.S. Oct. 7, 1985) (No. 85-599); *Disabled American Veterans* v. *United States*, 560 F.2d 1178 (Ct. Cl. 1981).

In the instant case, the parties stipulated that the advertising at issue constituted a "trade or business" which was regularly carried on. Therefore, the government was not required to establish that the advertising activity of the American College of Physicians met the first two tests under the regulations. The only issue was whether the advertising met the third test, that the advertising activity was not substantially related or did not contribute importantly, to the exempt purposes of the College.

In attempting to satisfy this test, the government has confused the criteria applicable to the first and third tests under the regulations and has utilized the criteria of the first test to establish that the third test is met. By focusing on the fact that the advertising activity of the College was engaged in for the production of income and was conducted in a "competitive, commercial manner" (the criteria applicable to establishment of the first test — "trade or business"), the government has confused the issue and seeks to create a rule which is not justified by the statute or the regulations thereunder.

Throughout its brief, the government argues that the only relevant inquiry is whether the advertising activity is commercial and contends that, if the activity is found to be a commercial in nature, then the activity must be held subject to tax.[2] The government's contention is in conflict with the statute and the regulations since it fails to recognize that all three tests must be satisfied before an activity may be subjected to taxation. Under the government's approach, *any* trade or business regularly carried on by a tax-exempt organization would be subject to the unrelated business income tax; the third test (unrelatedness) is ignored. Acceptance of the government's contention would require the invalidation or intentional refusal to acknowledge the plain language of the statute and the regulations.

Section 513(a) of the Internal Revenue Code expressly defines an "unrelated trade or business" as "any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function . . . " This language is repeated in Treasury Regulation Section 1.513-1(a). Treasury Regulation Section 1.513-1(d) defines the meaning of "substantially related" and provides that a trade or business will be so related if it "contribute[s] importantly to the accomplishment of [exempt] purposes."

Under the government's methodology, the "only relevant inquiry" is whether the activity in question is "commercial." If the answer to that inquiry is in the affirmative, then (according to the government) no further inquiry is necessary — the activity is per se deemed to be an unrelated trade or business. Under the test proposed by the government, none of the examples set forth in the regulations, in which income is determined to be exempt from the

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[2] "Under the Regulation . . . , the only relevant factual question is whether respondent's advertising is *commercial* publicity . . . " Brief for the United States at 10 and 30. (Emphasis in original). The Treasury and IRS examiners have reviewed advertisements in tax-exempt journals under an established approach "that *commercial* advertising is unrelated per se to exempt purposes . . . " *Id.* at 42. (Emphasis in original).

unrelated business income tax, would be correct interpretations of the statute.

In Treasury Regulation Section 1.513-1(d)(4)(i), Example (3), for instance, it is stated that the income received by an industry trade association from rental charges and admission fees in connection with a trade show will not be subject to taxation. According to the Example, the purpose of the trade show "is the promotion and stimulation of interest in, and demand for, the industry's products in general . . . " The exhibitors at the trade show rent display space in order to "advertise" their products and services and pay the trade association sponsor for the use of such display space. The Example concludes that the payments to the trade association are not unrelated business income. Under the test proposed by the government in the instant case, however, the opposite conclusion would have to be reached. Under the facts in Example (3), it is clear that the trade show is "commercial" in nature and, under the government's test, the commercial nature of that activity would foreclose an inquiry as to whether the activity contributed importantly to the exempt purposes of the trade association. Therefore, the trade show income would be subject to taxation.

A similar result would be mandated in regard to the facts set forth in Treasury Regulation Section 1.513-1(d)(4)(iv), Example (5). In that example, an exempt university provides for the publishing of a campus newspaper by the students. The newspaper publishes paid advertising which is solicited, sold and published by the students. The Example states that "the services rendered to advertisers are of a commercial character;" nevertheless, the Example concludes that the advertising revenues are not subject to taxation since "the advertising business contributes importantly to the university's educational program through the training of the students involved." Under the test advocated by the government in the instant case, the "commercial character" of the advertising would render the advertising income per se taxable.

Thus, the flaw in the government's contention is obvious. The commercial character of an activity, standing alone, cannot be determinative of the taxability of the activity. The commercial character of the activity merely provides guidance as to whether the activity is a "trade or business" which *may* be subject to taxation. If the commercial character of the activity is sufficient to constitute the activity as a trade or business, then the inquiry must be made as to whether the activity contributes importantly to exempt purposes. Only the answer to the latter inquiry can be dispositive as to the taxability of the activity.

III. EXAMPLE 7 CREATES NO PER SE RULE AS TO THE TAXABILITY OF ADVERTISING INCOME

The government contends that Example 7, appearing in Treasury Regulations Section 1.513-1(d)(4)(iv), represents a per se rule that *all* advertising appearing in *all* tax-exempt publications is subject to the unrelated business income tax. The government's interpretation of Example 7, however, suffers from the same flaw which invalidates the government's construction of the statutory language, i.e., that if an activity is commercial in nature then the activity must be deemed subject to taxation. Assuming that Example 7 is valid (an issue which your amicus does not concede), the Example only stands for the proposition that ordinary, commercial advertising is subject to taxation.

As was pointed out in the previous argument, the mere commercial nature of advertising is not dispositive as to whether the advertising is subject to taxation. In each instance, the advertising must be scrutinized to ascertain whether the advertising "contributes importantly" to the accomplishment of exempt purposes; if it does, then the advertising will not be subject to taxation. The regulations contain five examples which involve advertising, Treasury Regulation Section 1.513-1(d)(4)(iv), Examples (3), (4), (5), (6) and (7), and as previously has been demonstrated, one of those examples concludes that the advertising is not subject to taxation. Example (5). The very fact that one of the advertising examples reaches that conclusion refutes the government's contention that Section 513(c) of the Internal Revenue Code represents a "blanket" or "per se" rule that all advertising is subject to

the unrelated business income tax. The examples are set forth to establish the operation and application of the "fragmentation principle," not to establish the taxability of *all* advertising.

Examples (6) and (7) concern the tax treatment of advertising appearing in magazines published by tax-exempt organizations. In both examples, it is conceded that the articles and editorial content of the magazines contribute importantly to the exempt purposes of the publishing organization; therefore, the circulation income is not subject to taxation. To demonstrate the application of the fragmentation principle, however, the Examples go on to analyze the taxability of the advertising appearing in the magazines.

In Example (6), the advertising consists of "general consumer advertising, including advertising of such products as soft drinks, automobiles, articles of apparel, and home appliances." The Example concludes that the revenue earned from the sale of such advertising will be subject to taxation because "[n]either the publication of such advertisements nor the performance of services for such commercial advertisers contributes importantly to the accomplishment of any purpose for which exemption is granted." This latter conclusion is stated as a conclusary matter of fact and, to that extent, the Example is flawed. As pointed out above, the key inquiry is whether the activity under scrutiny "contributes importantly" to exempt purposes. The resolution of that inquiry requires a finding of fact. If there is a finding of fact that an activity does not contribute importantly to exempt purposes, then, as a matter of law, the activity will be subject to taxation. Although the analysis in Example (6) is flawed by the inclusion of a conclusory finding of fact, it is clear that the advertising described therein does not contribute importantly to exempt purposes.

The flaw in the example highlights, however, the same flaw in the government's argument. The government contends that all advertising is commercial in nature and, therefore, that advertising cannot contribute importantly to exempt purposes. In other words, the government seeks to establish an irrebuttable presumption that advertising is unrelated to exempt purposes and,

thereby, to establish *as a fact* that all advertising is taxable. The Court below recognized that such a factual presumption and conclusion was unwarranted under the statutory language and contrary to the directives of the regulations: "whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the *facts and circumstances involved*." Treasury Regulation Section 1.513-1(d)(2). (Emphasis added). A sensitivity to the importance of the factual inquiry in determining whether an activity is "substantially related" is required in order to understand why Example (7) is not dispositive in the instant case.

Example (7) states that it is based on the same facts as those set forth in Example (6) "except that the advertising in Z's journal promotes only products which are within the general area of professional interest of its members." There are, however, several additional facts set forth in regard to the nature of the advertising and, as in Example (6), a conclusory factual statement as to the "relatedness" of the advertising. It is that conclusory factual statement which differentiates Example (7) from the case at bar and other similar advertising activities of tax-exempt organizations. The "factual" matters discussed in Example (7) are set forth below:

> Following a practice common among taxable magazines which publish advertising, Z requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, Z accepts advertising only from those who

> are willing to pay its prescribed rates. Although continuing education of its members in matters pertaining to their profession is one of the purposes for which Z is granted exemption, the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute; it differs fundamentally from such an activity both in its governing objective and in its method.

Of particular note is the statement that "the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products *and differs in no essential respect from the informational function of any commercial advertising*." (Emphasis added).

Thus, the advertising in Example (7) contains only that information which would be present in ordinary commercial advertising directed to the general public. Such is not the case in regard to the advertising at issue in the instant case. The advertising in the instant case serves an "informational function" far different from that of "any commercial advertising," for the advertisements in the instant case present detailed and comprehensive information in regard to the products which are being advertised, information which would not be included in "ordinary commercial advertising."

It is this crucial distinction which the government fails to grasp or, possibly, deliberately prefers to eschew. Neither the Respondent nor your amici contend that "ordinary commercial advertising" (such as that involved in Example 7) is exempt from taxation. Rather, we contend that where advertising has a significant informational and educational component which contributes importantly to a nonprofit organization's exempt purposes and functions, then such advertising is not subject to taxation.

The distinction between "ordinary commercial advertising" and advertising which, although partly commercial in nature, contains significant educational information is precisely the distinction which was recognized by the court below. This Court

also, in its "commercial speech" cases, has recognized that there are gradations of commercial speech. On the one hand, there is "pure" commercial speech (something akin to "ordinary commercial advertising") which is represented by advertising which does no more than propose a commercial transaction; on the other hand, there are other types of commercial speech or advertising which go beyond the mere proposal of a commercial transaction and provide the recipients of the advertising with valuable information. *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976); *Bigelow* v. *Virginia*, 421 U.S. 809 (1975). In the context of determining whether speech is commercial or non-commercial for the purpose of ascertaining the amount of First Amendment protection to which the speech is entitled, this Court has stated: "The mere fact that [printed materials] are conceded to be advertisements clearly does not compel the conclusion that they are commercial speech. Similarly, the reference to a specific product does not by itself render the [printed materials] commercial speech. Finally, the fact that [the publisher] has an economic motivation for [publishing] the [printed materials] would clearly be insufficient by itself to turn the material into commercial speech." *Bolger* v. *Youngs Drug Products Corp.*, 463 U.S. 60, 66-7 (1983) (citations and footnote omitted). Thus, this Court has recognized that commercial advertising can have differing levels of informational value and that the legal treatment and informational content of advertising is to be considered separately from the economic or commercial motivation of the publisher. Advertising may perform the function of providing the recipient with important and educational information, just as the advertising in the instant case does.

Your amicus does not mean to suggest that the same tests which this Court has utilized to distinguish commercial speech from noncommercial speech are directly applicable to the case at bar. In the context of distinguishing commercial speech from noncommercial speech, this Court has been concerned with the amount of First Amendment protection to which such speech was entitled. That is a far different question from the question posed in the instant case. This case does not involve constitutional

issues; it merely involves interpretation of a section of the Internal Revenue Code. Our reference to the "commercial speech" cases is solely for the purpose of demonstrating this Court's recognition of the fact that advertising can serve a function separate and apart from the mere proposal of a commercial transaction. Once it is understood that advertising can serve other than commercial purposes, then it is possible to perceive the manner in which advertising, such as that in the instant case, can serve the exempt purposes of a nonprofit organization by providing educational information.

As previously noted, in Example (7) of the regulations, it is stated as a fact that the advertising described in that example has an informational function which "differs in no essential respect from the informational function of any commercial advertising." With that factual predicate, the Example goes on to state that "the publication of advertising designed and selected in the manner of *ordinary commercial advertising* is not an educational activity of the kind contemplated by the exemption statute." Your amicus has no quarrel with this statement, standing alone. "Ordinary commercial advertising" is subject to the unrelated business income tax. Advertising, such as that in the instant case, however, is *not* "ordinary commercial advertising."

The advertising in the instant case does not consist solely of an invitation by the advertiser to the reader to purchase a particular product or service. Rather, it alerts the reader to the existence of specified products and services and, further, provides the reader with an extensive amount of information as to those products and services. Thus, advertising such as that in the instant case is not "designed and selected in the manner of ordinary commercial advertising" and, therefore, its taxability is not governed by Example (7).

Moreover, due heed must be paid to the manner in which the advertising contributes importantly to the accomplishment of exempt purposes. In Example (5) under the regulations, the commercial advertising business engaged in by a campus newspaper was held to contribute "importantly to the university's educational program through the *training* of the students involved." The American College of Physicians, as well as many other

organizations exempt from taxation under section 501(c)(3) and 501(c)(6), has among its exempt purposes the education of its members and the advertising, which appears in the journals sent to those members, may serve those educational purposes to the same extent that the campus newspaper's advertising business assists in the education and training of students. Obviously, the presentation of "ordinary commercial advertising" will not serve to accomplish the educational purposes of a 501(c)(3) or 501(c)(6) organization. Where, however, the advertising pertains to products and services of professional interest to the members of those organizations and contains particularized information, which normally would not be included in advertising of the same products and services when directed to the general public, then such advertising has two distinct aspects and functions. It provides a commercial message and it serves to provide the readers with significant educational information which will assist them in their professions. As the court below held, if the educational function of such advertising contributes importantly to exempt purposes, then the commercial nature of the medium in which the information is conveyed will not require imposition of the unrelated business income tax.

The advertising considered in Example (7) differed "in no essential respect" from "any commercial advertising." The advertising in the instant case and the advertising contained in the publications of many other non-profit organizations does differ from ordinary commercial advertising. It contains details and information which would not be included in advertising directed to the general public and it serves an important educational function in alerting the readers to, and keeping them advised of, information which is useful to them in their professions. Thus, this type of advertising contributes importantly to the accomplishment of exempt purposes and is substantially related to those purposes. As a result, such advertising is different from that considered in Example (7) and is not subject to the unrelated business income tax.

IV. AFFIRMATION OF THE DECISION BELOW WILL NOT IMPOSE UNNECESSARY ADMINISTRATIVE BURDENS

The government contends that affirmance of the decision below will impose "formidable burdens on IRS audit resources" since IRS examiners no longer will be able to rely on a per se rule that *all* advertising is taxable. Brief for United States at 42. According to the government, "IRS examiners were not required to investigate the 'educational' function of advertisements on an ad-by-ad basis," in the past. *Id.* If, indeed, that is true, the only result of affirmance in the instant case would be a requirement that IRS examiners administer the tax laws in accordance with statutory language, rather than relying on an arbitrary rule which is not supported by law.

The government further complains that the court of appeals "has provided no workable standard" by which to assess the taxability of advertising activities. Such, however, is not the case. The standard applied by the court of appeals is exactly that mandated by the statute and the regulations. If advertising activity is determined to be a trade or business which is regularly carried on, then the advertising must be analyzed to determine whether it is "substantially related" or "contributes importantly" to the exempt purposes of the publishing organization. Administration of this standard may well require determination on a case-by-case basis, but there can be no other result where a tax law is to be applied on a "facts and circumstances" basis, and the regulations specifically provide that the determination of "[w]hether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved." Treasury Regulation Section 1.513-1(d)(2).

In administering the unrelated business income tax law, the Internal Revenue Service has long been familiar with the necessity to examine activities on a case-by-case, and even a category-by-category, basis. In Rev. Rul. 73-104, 1973-1 C.B. 263,

the Service concluded that the sale of greeting cards by a tax-exempt art museum did not give rise to taxable income where the greeting cards depicted works of art and, thereby, contributed importantly to the museum's exempt purposes of "stimulating and enhancing public awareness, interest, and appreciation of art." The Service reached that conclusion despite the "fact that the cards are promoted and sold in a clearly commercial manner at a profit and in competition with commercial greeting card manufacturers . . ."

Rev. Rul 73-105, 1973-1 C.B. 264, also involved the sales activities of a tax-exempt art museum. In that ruling, however, the museum not only sold items which depicted artistic works but also sold "scientific books and various souvenir items relating to the city in which the museum is located." In determining whether the museum's sales activities were subject to the unrelated business income tax, the Service recognized that it had to address each category of sales items separately:

> Thus, sales of a particular line of merchandise may be considered separately to determine their relatedness to the exempt purpose. Section 1.513-1(b)(2) of the regulations emphasizes that it is the particular facts and circumstances involved in each case which determines whether the activities in question contribute importantly to the accomplishment of any purpose for which the organization is exempt.

Applying these principles to the museum's sales items, the Service concluded that the items which depicted artistic works did not give rise to taxable income since those items contributed importantly to the museum's exempt purposes. Income from the sale of the scientific books and souvenirs, however, was determined to be taxable because the sale of those items did not contribute to the exempt purpose of enhancing the public's understanding and appreciation of art.

Thus, the Service has long recognized that application of the unrelated business income tax requires separate consideration of each aspect of a trade or business. In numerous private letter

rulings and general counsel memoranda, issued subsequent to the above revenue rulings, the Service has engaged in a category-by-category analysis when reviewing museum gift shop and hospital gift shop sales. Moreover, in those memoranda and rulings, the Service has stated that the difficulty of separating sales, category-by-category, is immaterial since the statute requires that each category be analyzed to determine taxability. Since the burden of proof is on the taxpayer, any duty to segregate ads by categories would be on the organization, not the examiner. Even this distinction becomes relevant only after the organization establishes that overall the advertising activity "contributes importantly" to the exempt function.

The government has offered no reason why advertisements should be treated differently from other activities, such as gift shop sales, other than the asserted fact that the IRS examiners have relied on a per se rule in regard to advertising. As has been demonstrated above, there is no legal justification for such a per se rule. The government's argument that the commercial nature of advertising must override the possible educational function of that advertising is of no avail. The greeting cards sold by the art museum in Rev. Rul 73-104, *supra*, were "promoted and sold in a *clearly commercial manner* at a profit and in competition with commercial greeting card manufacturers." Nevertheless, those sales were held nontaxable. The same treatment must be accorded advertising similar to that which is involved in the instant case.

CONCLUSION

For all of the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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Supreme Court of the United States

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UNITED STATES OF AMERICA,
Petitioner,

v.

AMERICAN COLLEGE OF PHYSICIANS,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

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BRIEF FOR AMICUS CURIAE AMERICAN ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 84-1737

UNITED STATES OF AMERICA,
Petitioner,

v.

AMERICAN COLLEGE OF PHYSICIANS,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

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BRIEF FOR AMICUS CURIAE AMERICAN ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE

PRELIMINARY STATEMENT

This brief is filed by American Association for the Advancement of Science, as amicus curiae, pursuant to the written consent of Petitioner and Respondent which are on file with the Court. American Association for the Advancement of Science ("AAAS") concurs in Respondent's formulation of the question presented in this litigation and concurs in the arguments, legal analysis and conclusions set forth in Respondent's

brief. AAAS's brief will primarily address the Government's assertion that a so-called blanket rule was adopted by Congress in the 1969 Tax Reform Act requiring the taxation of all commercial advertising revenues generated by professional journals published by exempt organizations.

INTEREST OF AMICUS CURIAE AMERICAN ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE

AAAS was organized in 1848 and is exempt from tax under Section 501(c)(3) of the Internal Revenue Code of 1954.[1] AAAS's membership consists of professional scientists, educators and other persons having a technical background or interest in the areas of science. AAAS publishes a weekly journal entitled *Science*. Through the publication of *Science*, AAAS fulfills its corporate and exempt purpose of furthering the work of scientists and improving the effectiveness of science in the promotion of human welfare.

Science was founded by Thomas A. Edison in 1880. Alexander Graham Bell was one of its successor publishers. Since 1900, *Science* has been the official publication of AAAS. Its technically oriented articles are usually written by scholars and scientists, which have included over 140 Nobel Prize winners.[2] *Science* is a

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[1] 26 U.S.C. § 501(c)(3). All references to the Internal Revenue Code and regulations promulgated thereunder are to provisions effective in 1975, unless otherwise indicated.

[2] Judge Greene noted that scientists who write articles for *Science* "[a]re paid nothing for their contributions but consider it an honor to be accepted for publication." *American Association for the Advancement of Science* v. *The Hearst Corporation*, 498 F. Supp. 244, 248 (D.D.C. 1980).

unique source of technical scientific information, and it reports the results of experiments and developments in *all* fields of science. AAAS has strived to make *Science* a clearinghouse where scientific discovery and the equipment necessary to bring about such discoveries are identified and discussed. AAAS believes this synergy is necessary because without improvements in the tools of science there can be little scientific advancement. Advances in instrumentation frequently open new areas of scientific inquiry.

Like Respondent's publication, *Science* contains a limited amount of advertising of a highly technical nature. *Science's* advertisements educate the scientific community in the latest technical developments in the tools and equipment of science.[3] As early as 1895, *Science* expressly restricted its acceptance of advertising to that which is relevant and informative to the scientific community it serves. Advertisers understand that their advertisements must be informative rather than promotional and factual rather than testimonial. In keeping with its advertising policy, *Science's* advertisements contain substantial technical and performance information concerning the equipment and chemicals presented in the advertisements. These advertisements convey far more information regarding the various functions, adaptations, performance standards and technical specifications of the product involved than is customarily found in commercial advertisements in popular science magazines.

---

[3] As noted by Judge Greene, advertisements in *Science* "[o]ffer laboratory equipment, chemical substances for experiments, and little else." *Id.* at 248.

In a recent technical advice memorandum,[4] the Internal Revenue Service held that *Science's* advertising revenues constituted income from an unrelated trade or business. The Court's decision in this case will have a direct and material impact on AAAS's continued ability to publish *Science*. Therefore, AAAS is submitting this brief to the Court in support of Respondent.

SUMMARY OF ARGUMENT

The Government, aided and abetted by commercial publishers, asks this Court to rule that Congress enacted a "per se" or "blanket" rule that all commercial advertising revenues of professional journals are subject to unrelated business income tax (Gov. Brf., pp. 27-28). The Government cites Example (7) of 1967 Treasury Regulations, Section 513(c) as enacted by the 1969 Tax Reform Act, selective portions of the Congressional Committee Reports and testimony at Congressional Hearings in support of its blanket rule (Gov. Brf., pp. 16, 22-27). The Government's analysis overlooks the plain language of Section 513(c), the applicable substantial relation test imposed and required by Section 513(a) and the applicable Regulations under Section 513. If the Government's argument is accepted, virtually no tax-exempt entities will be able to show that their advertising is substantially related to their exempt purposes, and some vitally important professional journals may be forced to cease publication. Congress could not have intended such a Draconian result.

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[4] LTR 8418002, dated December 26, 1983.

ARGUMENT

A. Section 513(a) Mandates That Journal Advertising Revenues Be Tested For Substantial Relation Before A Finding Of Unrelated Business Income Can Be Made.

Section 513(a) defines an "*unrelated* trade or business" as one which is not substantially related to the exempt purposes of a tax-exempt organization. The Treasury Regulations virtually repeat the statutory language in defining an *unrelated* trade or business. Treas. Reg. § 1.513-1(a).

In his message to Congress in 1950 concerning the adoption of the unrelated business income tax, President Truman stated:

> Responsible educational leaders share in the concern about the fact that an exemption intended to protect educational activities has been misused in a few instances to gain competitive advantage over private enterprise through the conduct of business and industrial operations *entirely unrelated* to educational activities. [Emphasis supplied.]

Hearings on Revenue Revision of 1950 Before Committee on Ways and Means, 81st Cong., 2d Sess. 4 (1950). Secretary of the Treasury Snyder echoed President Truman's remarks:

> These provisions [Sections 511-513] preserve the tax-free status of legitimate activities of educational and charitable organizations and, at the same time, correct the abuses which properly have received so much general condemnation.
>
> Business operations of charitable and educational institutions *clearly unrelated* to their exempt functions generally would be subjected to the regular corporation income tax.

Hearings on Revenue Revision of 1950 Before Senate Finance Committee, 81st Cong., 2d Sess. 6, 7 (1950).

Thus, the receipt of revenue by a tax-exempt organization should be subject to tax only if the activity generating the revenue is not substantially related to its exempt function. It is not the commercial nature of the activity which gives rise to tax, but, rather, it is the unrelatedness of the activity to the organization's exempt purposes which implements the tax. For example, no one can seriously contend that a tax-exempt hospital does not compete with a proprietary hospital in a commercial, business sense. Yet a tax-exempt hospital's receipt of fees for health care services is not unrelated business income since these services contribute importantly [i.e., are substantially related] to the purpose for which its exemption was granted. *See, e.g.*, S. Rep. No. 2375, 81st Cong., 2d Sess. 106-107 (1950).[5]

The emphasis on relatedness as a measure to determine whether commercial activities result in unrelated income is also mirrored in the Treasury Regulations. In commenting on what constitutes a trade or business, Treas. Reg. § 1.513-1(b) (1967) provides:

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[5] Similarly, a tax-exempt hospital's operation of a gift shop, frequented by patients, visitors of patients and its employees, does not constitute an unrelated trade or business. Rev. Rul. 69-267, 1969-1 C.B. 160. *See*, Rev. Rul. 69-268, 1969-1 C.B. 160 (tax-exempt hospital's operation of cafeteria primarily for its employees and medical staff not unrelated business) and Rev. Rul. 73-104, 1973-1 C.B. 263 (museum's sale to general public of greeting cards portraying its art works and the art works of other museums not unrelated business). Even though these activities are clearly commercial, profit-motivated activities, the Internal Revenue Service held that the activities contributed importantly to each organization's exempt purposes and, hence, were not subject to tax.

> In general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute 'trade or business' within the meaning of section 162—*and which, in addition, is not substantially related to the performance of exempt functions*—presents sufficient likelihood of unfair competition to be within the policy of the tax. [Emphasis supplied.]

This theme is continued later in the Treasury Regulations. In defining whether a commercial activity is substantially related, Treas. Reg. §§ 1.513-1(d)(1) and (2) (1967) provide that the commercial activity in question must be compared to the exempt purposes furthered by the activity. Equally important, this determination is not to be made by a blanket rule; rather, it "depends *in each case* upon the facts and circumstances involved." [Emphasis supplied.]

This statutory and regulatory framework has been part of our law for 35 years and mandates that commercial activities of a tax-exempt organization be tested on a case-by-case basis for substantial relation to determine whether the income from the activity results in unrelated business income.

B. Section 513(c) Did Not Preempt The Substantial Relation Test But Merely Allowed Commercial Activities Of A Tax-Exempt Organization To Be Segmented.

Elaborating on the term *trade or business,* Section 513(c) as enacted by the 1969 Tax Reform Act provided that a commercial activity conducted by an exempt organization will not lose its status as a *trade or business* merely because the activity is carried on

within a larger aggregate of exempt functions.[6] It does not say that a commercial activity will *ipso facto* lose its identity as a *related* trade or business. Section 513 (c) does not override, or even speak to, the issue of determining whether a fragmented commercial activity is substantially related to an organization's exempt functions.[7] This later analysis is mandated by Section 513(a), the Regulations promulgated thereunder and the plain meaning of Section 513(c). Section 513(c) merely validated the 1967 Treasury Regulations approach to fragmenting commercial business activities of an exempt organization.[8] As properly stated by the Federal Circuit below:

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[6] Section 513(c) (1969) provides in pertinent part: [A]n activity does not lose identity as a *trade or business* merely because it is carried on within a larger aggregate of similar activities . . . which may, or may not, be related to the exempt purposes of the organzation. [Emphasis supplied.] This language has remained unchanged to the present day.

[7] The Government has apparently dropped its argument that Section 513(c) is a "more specific" provision overriding the general rule [testing for substantial relation] of Section 513(a), since this argument was properly rejected by the Federal Circuit below. To achieve the same result, the Government now argues to this Court that Example (7) and selected portions of the Committee Reports require Section 513(c) to be so read.

[8] Section 513(c) virtually repeated the language of the 1967 Treasury Regulations regarding the fragmentation concept. "Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as *trade or business* merely because they are carried on within a larger aggregate of similar activities or within a larger complex of endeavors which may, or may not, be related to the exempt purposes of an organization." [Emphasis supplied.] Reg. § 1.513-1(b), 32 Fed. Reg. 17657 (1967). Like Section 513(c), these regulations do not state that a commercial activity will not lose its identity as *an unrelated* trade or business.

> Congress made no change to the 'substantial relation' or 'convenience' tests of section 513(a). Instead, it amended the statute *only* to provide that advertising activity shall be treated as a separate trade or business for purposes of analysis. [Emphasis in original.] [9]

Both courts below correctly undertook the substantial relation analysis after considering the statutory and regulatory framework of Section 513. This approach was in accord with the approach taken by sister circuits. Considering the sale of pharmaceutical drugs by a tax-exempt hospital, both the Seventh Circuit and the Fifth Circuit recently undertook the substantial relation analysis required by Section 513(a) in deciding whether such sales were unrelated business income.[10] In *Hi-Plains Hospital, supra* n.10, the Fifth Circuit expressly rejected the Government's argument that Section 513(c) created a *per se* rule that commercial pharmaceutical sales by an exempt hospital to the public constituted unrelated business income. *Id.* at 532-533. This Court should similarly reject the Government's attempt to rewrite the unambiguous language of Section 513(c).

If Section 513(c) were read to create the blanket rule regarding advertising activities advanced by the

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[9] *American College of Physicians* v. *U.S.*, 743 F.2d 1570, 1575 (Fed. Cir. 1984).

[10] *Carle Foundation* v. *U.S.*, 611 F.2d 1192, 1196 (7th Cir.), *cert. denied*, 449 U.S. 824 (1980) and *Hi-Plains Hospital* v. *U.S.*, 670 F.2d 528, 530 (5th Cir. 1982). Pharmaceutical sales, like advertising activities, are listed as examples of activities which must be fragmented from exempt functions and treated as a separate trade or business. Treas. Reg. § 1.513-1(b), 32 Fed. Reg. 17657 (1967).

Government, then (because the Section does not distinguish between any specific type of commercial activity)[11] that Section would have to be read to create the same blanket rule for all component commercial activities of exempt organizations. How can the plain language of Section 513(c) be read to contain a *per se* rule for one commercial activity and a different rule [i.e., fragmentation only] for other commercial activities without expressly so stating?

C. The Legislative History Of Section 513(c) Does Not Support The So-Called Blanket Rule Advanced By The Government.

The Government cites selected portions of the House and Senate Reports[12] as support for its position that the language of Section 513(c) creates a blanket rule that all advertising revenues in a tax-exempt organization's publication constitute unrelated trade or business income (Gov. Brf., pp. 24-26). The Reports cannot be so read. The Committee Reports indicate that Congress, in enacting Section 513(c), was primarily concerned with validating the mechanism created in the 1967 Regulations to fragment an exempt organization's commercial activities from its exempt functions. House Report at 50. The Senate would have fragmented only three commercial activities, including advertising, but

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[11] The use of the term "advertising" in the title to Section 513 (c) does not limit the scope of the Section to advertising alone. Section 7806(b) makes clear that the title of a Code Section is not to be "given any legal effect."

[12] H.R. Rep. No. 91-413 (Part 1), 91st Cong., 1st Sess. 50-51 (1969) ("House Report") and S. Rep. No. 91-552, 91st Cong., 1st Sess. 75 (1969).

its view was rejected by the Conference Committee in favor of the more general House version.[13] The Conference Committee Report merely repeated the fragmentation concept common to the House and Senate versions of the bill. Most important, however, it made no reference to any blanket rule that journal advertising revenue automatically constitutes unrelated business income.

In its Supplemental Report[14] containing a technical explanation of the 1969 Tax Reform Act, the House Ways and Means Committee again reiterated the fragmentation rule common to both versions of the bill and concluded with respect to the intent and legal effect of the fragmentation rule:

> Therefore, *for example,* the advertising contained in a publication of an exempt organization *may* be subject to tax under section 511 even though the editorial content of the publication may be related to the exempt purposes of the organization. [Emphasis supplied.]

This language does not create a blanket rule. By using the term "may", Congress affirmed the principle inherent in Section 513(c) that fragmented commercial activities must be tested for substantial relation before a finding of unrelated business income can be made. As indicated by the Fifth Circuit in *Hi-Plains Hospital,* and by the Supplemental Report, there are two questions to be addressed. First, can the activity be fragmented? Then, there is an additional, more

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[13] H.R. Rep. No. 91-782, 91st Cong., 1st Sess. 292 (1969) ("Conference Committee Report").

[14] H.R. Rep. No. 91-413 (Part 2), 91st Cong., 1st Sess. 26 (1969).

fundamental question to be answered after fragmentation: is the fragmented commercial activity substantially related to an organization's exempt purposes?

If Section 513(c) is read automatically to answer the latter question negatively regarding publication advertising activities of an exempt organization, then that Section must be read as creating two different rules for component commercial activities. The first rule, a *per se* one, would provide that publication advertising activities are automatically unrelated. The second rule would provide that other component commercial activities, e.g. a museum's sale of greeting cards to the public (Rev. Rul. 73-104, *supra*), are fragmented into a separate trade or business and are then tested for substantial relation under Section 513(a). The statute plainly does not create two different rules and cannot be so read. If it were so read, the blanket rule would have to reach not only advertising but all commercial activities conducted as one component of larger exempt activities, and the substantial relation test would be a nullity.

D. Example (7) Does Not Create A Blanket Rule That All Journal Advertising Revenue Of Exempt Organizations Is Unrelated Business Income.

Finding no support for its so-called blanket rule in the plain language of Section 513(c), the Government argues that Example (7) creates a blanket rule and that Congress intended Section 513(c) to implement this rule (Gov. Brf., p. 24). As indicated above, neither the plain language of Section 513(c) nor the Committee Reports explaining that Section justify such a construction of the statute.

The Government's argument in favor of construing Example (7) as a blanket rule is also belied by the position of the Internal Revenue Service. In Rev. Rul. 82-139, 1982-2 C.B. 108, the Revenue Service considered whether revenues received by a Section 501(c)(6) bar association from advertisements in its bar journal for products and services used by attorneys constituted unrelated business income. Although the products and services are not identified in the Ruling, the advertising in most bar journals is primarily general advertising of office products (e.g. word processing equipment), office supplies and legal books. Both Example (6) of the 1967 Regulations [15] and Example (7) would appear to be germane to the subject matter of the Ruling.

In holding that the advertising revenues were unrelated business income, the Revenue Service did not even refer to Examples (6) and (7) as a basis for the result reached. This appears to be a change of position by the Revenue Service, since Example (6) was cited by it previously in Rulings dealing with the general advertising of exempt organizations.[16]

The Revenue Service cited Section 513(c) and Treas. Reg. § 1.513-1(b) as primary support for its conclusion. Interestingly, the Revenue Service cited a portion of Treas. Reg. § 1.513-1(b) concerning the advertising fragmentation principle, but it added the word

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[15] Treas. Reg. § 1.513-1(d)(4)(iv), Example (6), 32 Fed. Reg. 17657, 17659 (1967).

[16] Rev. Rul. 76-93, 1976-1 C.B. 170; Rev. Rul. 74-38, 1974-1 C.B. 144.

unrelated to the cited passage.[17] It then bootstrapped by stating that Section 513(c) and Treas. Reg. § 1.513-1(b) required a finding that the advertising revenues were *per se* unrelated income.[18]

AAAS submits that the only explanation for the Revenue Service's changed analysis in Rev. Rul. 82-139 is its tacit acknowledgement that neither Example (6) nor Example (7) constitute blanket rules of substantive law. This concession is proper since both Examples were promulgated as part of interpretative regulations under Section 513.[19] In an attempt to bypass the substantial relation test, the Revenue Service appears to have rewritten its own regulations in Rev. Rul. 82-139 by adding the word *unrelated* to Treas. Reg. § 1.513-1(b). Since the language of that Regulation and Section 513(c) is virtually identical, the Revenue Service then attributes the word *unrelated* to Section 513(c) and concludes that both statute and regulations have created a *per se* rule that publication

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[17] In Rev. Rul. 82-139, Treas. Reg. § 1.513-1(b) is cited in pertinent part as, "[a]ctivities of . . . publishing commercial advertising do not lose their identity as *an unrelated* trade or business. . . ." [Emphasis supplied.]

Treas. Reg. § 1.513-1(b) actually reads, "[a]ctivities of . . . publishing commercial advertising do not lose identity as a *trade or business*. . . ." [Emphasis supplied.]

[18] The Government bootstraps in the same manner in its brief. For example, it cites the trade or business fragmentation principle of Section 513(c) and concludes in the next sentence that the words of Section 513(c) expressly sanctioned " 'fragmentation' of an activity into exempt-purpose and *unrelated-business* components. . . . (Gov. Brf., p. 24). [Emphasis supplied.]

[19] Prop. Treas. Reg. § 1.513-1, 32 Fed. Reg. 5993 (1967).

advertising revenue is automatically unrelated.[20] The statute and the regulations do not remotely support the Revenue Service's analysis.

This bootstrapping analysis is also necessary because Example (7) is nothing more than what its title implies—an example. It specifies a particular set of subjective facts and tests for substantial relation. If the Treasury wanted to create a blanket rule, it strains logic to argue that it would have used an example in a subsection of a subparagraph to do so. Moreover, if the so-called blanket rule in Example (7) is deemed to be that advertising selected in the manner of ordinary commercial advertising is always unrelated to an organization's exempt purposes, then the Example improperly focuses on the commerciality of the activity, rather than the relatedness of the activity to an exempt purpose. The focus on commerciality rather than relatedness violates the plain language of Section 513(a), its legislative history and Treas. Reg. § 1.513-1(b) (quoted at p. 7 above).

E. Administrative Convenience Cannot Justify Rewriting Section 513(c) To Create A Blanket Rule.

In arguing for a blanket rule that publication advertising revenues always constitute unrelated business income, the Government seeks to apply a sledgehammer to a gnat. AAAS agrees with Respondent's position that professional advertising in many exempt organi-

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[20] Compare Rev. Ruls. 73-104 and 73-105, 1973-1 C.B. 263-264, which state, "Section 513(c) of the Code and Section 1.513-1(b) of the Income Tax Regulations provide that *trade or business* includes any activity which is carried on for the production of income from the sale of goods." [Emphasis supplied.]

zation journals is not substantially related to the exempt purposes of those organizations.[21] However, Respondent has presented a case in which professional advertising has contributed importantly to an exempt educational purpose, as found by the Federal Circuit.

By creating the substantial relation test in Section 513(a), Congress intended a factual analysis to be made of whether commercial activities further an exempt purpose in testing for unrelated income. That factual test has been applied by the Revenue Service for 35 years in all areas of activities of exempt organizations without apparent adverse effect. However, now it states that the lack of a blanket rule will cause a drain on its audit resources.

Although AAAS disagrees with the Revenue Service's position, it is for Congress and Congress alone to create *per se* rules. Congress has shied away in the past from blanket rules in the exempt organization area, especially with respect to Section 501(c)(3) public charities. There is no question that most charities to some extent lessen the burdens of government. For example, Congress indicated in 1938 that one primary reason for creating tax exemption for charities was that they relieve the Government of financial burdens

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[21] In addition to publishing the very technical *Science*, AAAS also publishes a monthly scientific, educational magazine entitled *Science 85*. This sister magazine is directed to a more broad-based readership and presents scientific articles more readable and understandable by individuals not formally trained as scientists. Since the inception of this sister magazine in 1979, AAAS has treated the advertising revenues generated by *Science 85* as unrelated business income, since these advertisements are of a general consumer nature. This is in marked contrast to the educational purpose and policy of advertisements presented in *Science*.

which would otherwise have to be met using government funds.[22] The unrelated business income tax itself was implemented in part to remove the former rule that a commercial endeavor of an exempt organization justified the loss of its tax exemption.[23] In an area requiring a sensitive balancing of the broad social purposes served by charities and the legitimate interests of the Government, Congress is charged with the responsibility of creating blanket rules, if the balancing test weighs in favor of such rules. It did not do so in 1969, and Section 513(c) cannot be read to do so now to serve the Revenue Service's convenience.

CONCLUSION

AAAS has limited its analysis in this brief to whether Congress adopted a blanket rule in 1969 to tax all publication advertising revenues of all exempt organizations. Congress could have chosen to do so, but it did not and Section 513(c) cannot be so read. If it were so read, the blanket rule would reach all commercial activities conducted as one component of larger exempt activities, not just advertising, and the substantial relation test, which has existed unchanged for 35 years, would be a nullity.

Although AAAS did not brief other legal arguments raised by Respondent in support of the decision below, it is in agreement with Respondent's legal analysis, reasoning and conclusions and, hence, this Court should affirm the decision of the Federal Circuit in this case.

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[22] H.R. Rep. No. 1860, 75th Cong., 3d Sess. 19 (1938).

[23] Hopkins, *The Law of Tax-Exempt Organizations*, § 40.1, Ronald Press (4th ed. 1983).

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Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA

Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS

Respondent

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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BRIEF FOR THE AMERICAN MEDICAL ASSOCIATION AND THE MASSACHUSETTS MEDICAL SOCIETY AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Is publication in the journal of a tax-exempt medical society, one purpose of which is medical education, of advertisements for items used in the practice of medicine, most of which pertain to pharmaceutical products and contain extensive prescribing information mandated by regulations of the Food and Drug Administration, "substantially related to" the tax-exempt purposes of such society, so that income received by the society from such advertisements is not subject to the tax on "unrelated business income" imposed by Sections 511-513 of the Internal Revenue Code?

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No. 84-1737

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA

Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS

Respondent

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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BRIEF FOR THE AMERICAN MEDICAL ASSOCIATION AND THE MASSACHUSETTS MEDICAL SOCIETY AS AMICI CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF AMICI CURIAE

Amici American Medical Association ("AMA") and Massachusetts Medical Society submit this brief with the written consent of all parties, copies of which consents are being filed herewith. Amicus AMA is a national, voluntary non-profit organization of physicians. AMA was founded in 1846 to promote the science and art of medicine and the betterment of public health. AMA is exempt from Federal income tax under Internal Revenue Code Section 501(c)(6).

Like the respondent in this case, AMA publishes scholarly medical journals in furtherance of its exempt purposes. In addition to scholarly articles, such journals contain display advertising for prescription drugs, books, continuing medical education and medical equipment and classified advertising primarily for medical positions.

AMA has pending in the United States District Court for the Northern District of Illinois (Civil No. 82-C-7213) a case raising the issue presented in this case. AMA believes that its situation is similar to that of respondent and that the decision in this case will affect the result of AMA's litigation and consequently AMA's future publishing operations.

Amicus Massachusetts Medical Society (the "Society") is a non-profit, special act corporation organized and existing under the laws of the Commonwealth of Massachusetts since 1781. It is the oldest American medical association in continuous existence. Approximately 70% of the physicians registered to practice medicine in the Commonwealth of Massachusetts are members of the Society, which is the primary professional physicians' organization in Massachusetts. Among its principal concerns are promoting progress and improvement in the care, treatment and cure of patients. The Society is exempt from Federal income tax under Internal Revenue Code Section 501(c)(6).

The charter of the Society directs it to engage in the publication and distribution of journals and periodicals to be devoted primarily to the science and practice of medicine, and to conduct educational programs. Since 1921, the Society has published *The New England Journal of Medicine*. The *New England Journal* contains, in addition to scholarly articles on medicine, advertising similar to that in the publications of respondent; consequently the Society believes that the decision in this case will substantially affect its taxability under the Internal Revenue Code.

SUMMARY OF ARGUMENT

The Internal Revenue Code has always implemented a policy of exempting from taxation the income received by certain defined organizations thought to promote desirable social goals. Internal Revenue Code, § 501. Section 511 of the Internal Revenue Code, however, applies an unrelated business income tax to activities of such tax-exempt organizations which are "not substantially related" to the organizations' tax-exempt purposes. This "not substantially related" test, which appears in Section 513(a) of the Code, was enacted in 1950 and has never been amended. Thus, as in *Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978), and *Securities and Exchange Commission v. Sloan*, 436 U.S. 103 (1978), the Court in construing the test should place principal reliance upon the legislative history of the 1950 enactment and not, as petitioner urges, on later Congressional action that did not alter the test. It is clear from the legislative history of the 1950 enactment that Congress did not intend to change the non-taxable nature of traditional sources of income of tax-exempt organizations which had some relationship to the organizations' tax-exempt purposes. The general provisions of the Treasury Regulations, and Internal Revenue Service rulings in areas other than advertising, remain true to this intent.

The advertising in the journal of respondent American College of Physicians plainly meets the "substantially related" test as it was intended to be applied by the Congress that enacted it. Advertising in scholarly journals was a traditional means of raising income by tax-exempt medical societies at the time the unrelated business income tax was passed. And the advertising in respondent's journal, which relates primarily to pharmaceutical products and contains extensive prescribing information in a

complete and balanced format mandated by the Food and Drug Administration, unquestionably furthers in a substantial way respondent's purpose of providing medical education to its members.

Treasury Regulations directed to advertising income of tax exempt organizations which were adopted in 1967, some seventeen years after Congress enacted what is now Section 513(a), do not make respondent's advertising income taxable. The part of those Regulations which petitioner argues has such effect, Example 7 to Treas. Reg. § 1.513-1(d)(4)(iv), is addressed to advertising "designed and selected in the manner of ordinary commercial advertising." Pharmaceutical advertising of the type published by respondent, containing extensive mandated prescribing information of considerable educational value to physicians, is not "ordinary commercial advertising." Moreover, to the extent that Example 7 purports to make a conclusive presumption that any advertising "designed and selected in the manner of ordinary commercial advertising" is "not substantially related" to an organization's tax-exempt purposes, it is inconsistent with both the generally applicable provisions of the Regulations and the purpose and intent of Section 513(a) and must be held invalid.

Nor do the enactment of Section 513(c) of the Internal Revenue Code as part of the Tax Reform Act of 1969 or the legislative history of such enactment provide a ground for taxing respondent's advertising income. Section 513(c) itself does no more than permit application of the "not substantially related" test of Section 513(a) to a single "activity . . . carried on within a larger aggregate of similar activities;" it does not change the test in any way. Although the House and Senate Reports on the Tax Reform Act of 1969 express the opinion that adver-

tising by tax-exempt organizations is taxable, that opinion is couched in general terms and does not apply to highly educational advertising of the type published by respondent. On the contrary, a report by the staffs of the committees which considered the 1969 legislation expressly recognizes that "technical comment" in a pharmaceutical advertisement must be separated from "pure advertising." Staffs of the Joint Comm. on Taxation and the Senate Finance Comm., 91st Cong., 1st Sess., Summary of H.R. 13270, Tax Reform Act of 1969, Aug. 18, 1969, p. 31 (Comm. Print). In any event, as this Court has observed in such cases as *United States v. Price*, 361 U.S. 304, 313 (1960), statements in committee reports of a later Congress are of little value in construing a statute enacted by another Congress some nineteen years earlier.

The commercial nature of respondent's advertising is not relevant to the taxability of the income it produces. Petitioner concedes that respondent's subscription income "is unquestionably exempt from tax" notwithstanding the similarity of respondent's journals to commercial periodicals. Nor does administrative convenience require dispensing with a case-by-case examination of advertising to determine whether it is related to an organization's tax-exempt purpose. The Internal Revenue Service follows a case-by-case approach with respect to other activities of such organizations, without disabling effects.

The Court of Appeals correctly applied the letter and the intent of Section 513(a) of the Internal Revenue Code in this case, and its decision should be affirmed.

ARGUMENT

I.

THE ADVERTISING REVENUES OF RESPONDENT THE AMERICAN COLLEGE OF PHYSICIANS ARE NOT TAXABLE UNDER THE PLAIN LANGUAGE OF SECTION 513(a) OF THE INTERNAL REVENUE CODE, THE LEGISLATIVE HISTORY OF THAT SECTION, AND THE REGULATIONS, RULINGS AND DECISIONS APPLYING THAT SECTION TO OTHER ACTIVITIES.

The Internal Revenue Code has always exempted from taxation certain defined kinds of organizations thought to perform useful social functions. Internal Revenue Code, Section 501. Respondent has qualified for exemption under this section, and the Court of Appeals held that this exemption prevents taxation of the income received by respondent from advertisements published in its medical journals. Petitioner contends that such income falls within an exception to the exemption contained in Sections 511 through 513 of the Internal Revenue Code, which impose what is known as the unrelated business income tax. Petitioner's contention ignores the history and prior application of the unrelated business income tax and the very substantial contribution respondent's advertising makes to the education of its members.

A. Income-Producing Activities Of A Tax-Exempt Organization Are "Substantially Related" To Its Tax-Exempt Purposes, And Thus Not Taxable, If They Contribute To The Achievement Of Such Purposes, Regardless Of Whether They Are Carried On In The Manner Of An Ordinary Commercial Business.

The unrelated business income tax, now codified at Internal Revenue Code Sections 511 through 513, 26 U.S.C. §§ 511-513, was enacted in the Revenue Act of 1950, ch. 994, § 301, 64 Stat. 947. These provisions impose a tax upon the income, derived by an organization otherwise

exempt from Federal income tax, from a "trade or business the conduct of which is *not substantially related* . . . to the exercise or performance by the organization of its [exempt purposes]." Section 513(a) (emphasis supplied).

Although one of several concerns resulting in enactment of the unrelated business income tax was "unfair competition", *see, e.g.*, H.R. Rept. No. 2319, 81st Cong., 2d Sess., at 36 (1950),[1] the statutory requirement for taxability is that the income "is not substantially related" to the exempt purposes of the organization. Thus, under the plain language of the statute, *neither* the existence of competition *nor* the ordinary commercial character of the business is the touchstone for imposition of the tax.

The "not substantially related" test of Section 513(a) has never been amended since its enactment in 1950. The Tax Reform Act of 1969, upon which petitioner places so much reliance, made it possible to apply the test to a single "activity . . . carried on within a larger aggregate of similar activities" by adding Section 513(c) to the Code, *but it did not change the test.* See page 22, *infra*. Thus it is the 1950 statute, its legislative history, and rulings under it that principally determine what sorts of "activities" are subject to the unrelated business income tax. The inquiry the Court must make here is not unlike that it made in *Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978), and *Securities and Exchange Commission v. Sloan*, 436 U.S. 103, 119-121 (1978), in which the Court concluded that the legislative history produced by the Congress which passed the statute in question was far

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[1] This report places its discussion of the unrelated business income tax in a section entitled "Sources of Additional Revenue." *Id.* at 24.

more pertinent in ascertaining the statute's meaning than reports issued by subsequent Congresses which had not amended the statute.

1. The Legislative History Of The Revenue Act Of 1950 Demonstrates That Congress Did Not Intend To Tax Activities "Customarily Carried On" By A Tax Exempt Organization Which Had Some Relationship To The Organization's Tax-Exempt Purposes.

When Congress enacted the unrelated business income tax in 1950, it did not mean to alter significantly the traditional treatment of tax-exempt organizations. From its genesis, the unrelated business income tax was intended to apply only to income-producing activities of a tax-exempt organization which bore little or no relation to the organization's exempt activities.[2] In his message to Congress transmitting a request for a revision of tax laws, President Truman criticized the existing "exemption . . . misused in a few instances to gain competitive advantage over private enterprise through the conduct of business and industrial operations *entirely unrelated* to educational activities." *Revenue Revision of 1950: Hearings Before the House Comm. on Ways and Means*, 81st Cong., 2d Sess. at 4 (1950) (hereinafter cited as *1950 House Hearings*) (emphasis supplied).

Testimony of Treasury representatives at the 1950 hearings before both the House Ways and Means and the Senate Finance Committees emphasized that the new tax

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[2] The paradigm example of such activities was the ownership by New York University of the C.F. Mueller Company, a macaroni manufacturer. It was noted in Congressional debates that "there is nothing in the charter of that university, nor is there anything in its curriculum that is even remotely connected with the manufacture of spaghetti . . . ." 96 Cong. Rec. 9366, June 28, 1950 (remarks of Congressman Lynch).

was directed at unusual and clearly unrelated activities. Treasury Secretary Snyder stated before both Committees that the unrelated business tax would apply to business operations of exempt organizations that were "*clearly unrelated*" to their exempt purposes (emphasis supplied), such as "the manufacture of food products, leather goods, vegetable oils, and the distribution of petroleum products," but that "[t]he bill would not tax their income from related activities . . . customarily carried on by educational and charitable organizations." *1950 House Hearings* at 19; *Revenue Revisions of 1950: Hearings on H.R. 8920 Before the Senate Finance Comm.*, 81st Cong., 2d Sess. (1950) at 7 (hereinafter cited as *1950 Senate Hearings*). Vance Kirby, Tax Legislative Counsel of the Treasury, complained of business operations bearing "no relation" to the tax exempt purposes of the organization, and assured the Committee that "traditional sources of income" would remain tax exempt. *1950 House Hearings* at 165.

Similarly, the reports of the legislative committees on the bill which became the Revenue Act of 1950 demonstrate that Congress intended to tax unusual sources of income, but to leave untaxed the usual and traditional sources of income for tax-exempt organizations where some relationship with its tax-exempt purpose existed. Thus income received by a college "from charges for admissions to football games" would be related, but "the manufacture and sale of automobile tires . . . would ordinarily be considered an unrelated business." H.R. Rept. No. 2319, 81st Cong., 2d Sess. at 109 (1950); *accord* S. Rept. No. 2375, 81st Cong., 2d Sess. at 107 (1950).

This great a contrast between activities given for examples cannot have been accidental. Although a football game has some relationship to a college's educational purpose, education is not its predominant function. But this

and other traditional sources of support were to be excluded from the unrelated business tax. Manufacturing tires is not a traditional activity, and hence would be subject to tax.

This theme was continued in the floor debates on the Revenue Act of 1950. In debate, legislators stated that the unrelated business income tax was directed at businesses which were "totally unrelated" and not "even remotely connected" with the exempt purposes of the organization. 96 Cong. Rec. 9366, June 28, 1950 (remarks of Congressman Lynch). The unrelated business income tax was directed at exempt organizations which operated "businesses wholly unrelated to the purposes" for which the organizations were chartered, and was to apply in situations where "[t]here is no possible connection between some of the operations and the normal activities of these institutions." *Id.* at 9365. Other statements were to the effect that the statute was directed at abuses in which an organization "would, in effect, sell its tax exemption, and would go into some business unrelated entirely with the purpose" of the organization. *Id.* at 9364 (remarks of Congressman Simpson). Furthermore, the unrelated business income tax was to be imposed "only after being certain that no harm would be done to legitimate operations." *Id.* at 9365 (remarks of Congressman Lynch).

In light of the foregoing, and in the absence of any suggestion in the 1950 legislative history of a more stringent definition of "substantially related," the Court of Claims correctly concluded in 1976 that:

> The 1950 Act was a fairly limited measure, designed to distinguish the customary activities of exempt organizations from the operation of independent business enterprises *entirely unrelated* to the educational purpose of the organization.

American College of Physicians v. United States, 530 F.2d 930, 933 (Ct. Cl. 1976) (emphasis supplied). Congress had no intention when it enacted the Revenue Act of 1950 of taxing such traditional activities as advertising in professional journals of tax-exempt organizations when that advertising bore some relationship to the purposes of the organization. *See* Note, *The Macaroni Monopoly: The Developing Concept of Unrelated Business Income of Exempt Organizations*, 81 Harv. L. Rev. 1280, 1291 (1968). And no attempt was made to tax such advertising under the 1950 statute for seventeen years after the statute was enacted.

2. Generally Applicable Treasury Regulations, Internal Revenue Service Rulings Thereunder With Respect To Activities Other Than Advertising, And Lower Court Decisions All Recognize The Broad Definition Of "Substantially Related" Activities Which Congress Intended.

The generally applicable Treasury regulations promulgated under Sections 511 through 513 recognize the nature of the statutory test. They state that business activities are not subject to the unrelated business income tax "where the conduct of the business activities has causal relationship to the achievement of exempt purposes" and where such activities "contribute importantly" to the accomplishment of those exempt purposes. Treas. Reg. § 1.513-1(d)(2), set out at Pet. App. 47a-48a. The regulations further state that resolution of the issue "depends in each case upon the facts and circumstances involved." *Id.*

Decisions of the Internal Revenue Service in areas *other* than advertising recognize the exempt nature of income from traditional activities of a tax exempt organization even though such activities are carried on in the manner of an ordinary commercial business, where there is some

relationship to the organization's tax-exempt purposes. In Revenue Ruling 73-104, 1973-1 C.B. 263, income obtained by an art museum from the sale of greeting cards displaying reproductions of selected works from the museum's collection and other collections, which were sold in a shop operated in the museum, by mail order through a catalog published by the museum, and to retail stores at quantity discounts, was held to be non-taxable. The ruling states that "[t]he fact that the cards are promoted and sold in a clearly commercial manner at a profit and in competition with commercial greeting card publishers does not alter the fact of the activity's relatedness to the museum's exempt purpose." 1973-1 C.B. at 264.

Similarly, the operation by a museum of a restaurant, Revenue Ruling 74-399, 1974-2 C.B. 172, and the operation by a hospital of a gift shop, a cafeteria and coffee shop, and a parking lot, Revenue Rulings 69-267, 69-268 and 69-269, 1969-1 C.B. 160-61, all are related activities, even though such activities are conducted to raise revenue and are operated in the manner of ordinary commercial establishments.

Of particular relevance here is Revenue Ruling 75-516, 1975-2 C.B. 220, presenting the issue whether income which an organization exempt under Section 501(c)(6) derives from the rental of display space at its convention "to exhibit and demonstrate products and services used by the [organization's] members in their businesses" is related or unrelated income. The Ruling holds that "[t]he display and presentation of instructional material concerning the common business interests of the members, as part of an annual membership convention, contribute importantly to the advancement of the organization's exempt purpose" of "imparting general information to members about changing business conditions and the availability of new products and services" and that income derived therefrom is

"related" and not taxable. Thus, income received by a tax-exempt medical society from exhibitors of medical products at its conventions is not taxable, even though such exhibitors disseminate to physicians attending the conventions materials that are identical to the advertisements placed by such exhibitors in medical journals.[3]

Furthermore, in instances in which the Internal Revenue Service attempted to extend the unrelated business income tax to traditional sources of support of tax-exempt organizations, those efforts were rejected by the courts. *Maryland State Fair and Agricultural Society, Inc. v. Chamberlin*, 55-1 U.S. Tax Cas. (CCH) ¶ 9399 (D. Md. 1955) (horse racing "customary" and conducted "habitually" in conjunction with fair); *Mobile Arts and Sports Association, Inc. v. United States*, 148 F. Supp. 311 (S.D. Ala. 1957) (Senior Bowl football game an "integral part" of organization's civic and educational program).

More recent decisions of lower courts construing the provisions of the unrelated business income tax also have uniformly considered the presence or absence of a substantial relationship between the activity and the organization's exempt purposes to be the sole determinant of taxability. *Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1982); *San Antonio Bar Association v. United States*, 80-2 U.S. Tax Cas. (CCH) ¶ 9594 (W.D. Tex. 1980). "The regulations [Treas. Reg. § 1.513-1(d)] require a case-by-case identification of the exempt purpose, an analysis of how the activity contributes to that purpose and an

[3] Section 513(d), effective October 4, 1976, now expressly provides that qualified trade show activities, including activities described in Revenue Ruling 75-516, do not give rise to unrelated business income. The Internal Revenue Service on August 12, 1985 declared Revenue Ruling 75-516 obsolete in light of Section 513(d). Rev.Rul. 85-123, 1985-32 I.R.B. 8.

examination of the scale on which the activity is conducted." *Hi-Plains Hospital, supra*, 670 F.2d at 531. The question of whether an activity contributes importantly to an organization's exempt purpose must be considered "in light of the particular facts and circumstances of [the organization's] case." *Id.*

B. Respondent's Advertising Is "Substantially Related" To Its Tax-Exempt Purpose Of Providing Medical Education Within The Meaning Of Section 513(a) And Is Thus Not Taxable.

Respondent's exempt purposes, as conceded by petitioner, are:

> "(1) to uphold and to maintain high standards in medical education, medical practice and medical research, (2) to encourage research, especially in clinical medicine, and (3) to foster measures for the prevention of disease and for the improvement of public health."

J.A. 16a. In furtherance of its exempt purposes respondent publishes *Annals of Internal Medicine*, which since 1927 has contained both scholarly articles relevant to the practice of internal medicine and advertisements relating only to medical products, 80 percent of which are for prescription drugs.

This is not "garden variety commercial" advertising. The contents of advertisements for prescription drugs are dictated by the Food and Drug Administration. FDA regulations, 21 C.F.R. Part 202, require such advertising to contain detailed information as to the composition of the drug, its indications, contraindications, precautions, side effects, effectiveness and dosage. A prescription drug advertisement thus constitutes a mini-article about the advertised drug and has substantial educational value in its own right.

The uncontested testimony of respondent's witnesses at the trial in this case establishes that drug advertising fulfills an *important* educational function.

Respondent's witnesses testified that "[t]he sophisticated decision of when to use and not use drugs" is "at the very heart of internal medicine," J.A. 43a (testimony of Dr. Stewart Bondurant, Dean of the School of Medicine of the University of North Carolina), and that it is essential for a physician to keep up with developments in drugs.

The "use of journals" is "one of the keystones of a personal program of continuing education," J.A. 44a (testimony of Dr. Bondurant). The use of journals includes the review of advertisements. "[I]t's especially important that . . . the editorial content be looked at in a sort of point-counterpoint relationship with the advertising in [respondent's] Journal, because neither one alone would give a practicing physician a full basis of knowledge about using the drug." J.A. 38a (testimony of Dr. Louis Lasagna, Professor of Pharmacology and Medicine at the University of Rochester School of Medicine). Dr. Bondurant also testified as to the educational value of drug advertising, stating that "[t]he material in the advertisements serves in a very effective way . . . as an alerting function," J.A. 43a, and that such advertising complements the scientific portion of the journal. *Id.*

The educational value of drug advertising has been noted elsewhere. In testimony before the Monopoly Subcommittee of the Select Committee on Small Business of the United States Senate on August 10, 1967, Dr. James L. Goddard, who was then Commissioner of the Food and Drug Administration, stated that the purpose of proposed new FDA regulations specifying the contents of prescription drug advertising was "to get [drug companies] to

adopt the basic concept that drug advertising is educational and thus should be truthful, that it differs from advertising of motor vehicles and other items in our economy, that there is a special significance here." Dr. Goddard further testified before the Subcommittee on that date as follows:

> Medical advertising has been cited before this committee as one of the forms of continuing education of the doctor. I would agree with this appraisal, for—whether good or bad—industry spends some $3,000 per year per doctor on promotion. I have described to you our attempts to assure better medical advertising. We will continue to strengthen our monitoring of such advertising.

Competitive Problems in the Drug Industry: Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business, 90th Cong., 1st Sess. at 749 and 821 (1967).

The advertising in respondent's journal is required by law to be educational. It is sought out and used for its educational content by physicians as part of their continuing education. It complements the editorial content of respondent's journal and respondent's other educational programs. Such advertising therefore "contributes importantly" to respondent's exempt educational purpose and, under the standard of Section 513(a), is substantially related to such purpose. The income from such advertising is not unrelated business income.

II.

THE ARGUMENTS ADVANCED BY THE UNITED STATES FOR DEPARTING FROM THE PLAIN LANGUAGE OF SECTION 513 OF THE INTERNAL REVENUE CODE IN THIS CASE ARE WITHOUT MERIT.

Petitioner urges reversal of the decision below principally upon the grounds (1) that Treasury Regulations adopted in 1967 set forth a "per se rule" or "blanket rule" that all advertising is taxable (Pet. Brf., pp. 11-18, 27-28), and (2) that Congress in 1969 specifically approved this "per se rule" (*Id.* at 18-26). Petitioner also argues that reversal of the decision below is supported by considerations of administrative convenience and the commercial purpose and effects of respondent's advertising (Pet. Brf., pp. 41-43). None of these arguments is sufficient to overcome the plain language of Section 513(a) and the clear intent of Congress in enacting that provision.

A. Taxation Of Respondent's Advertising Revenues Is Not Justified By The 1967 Treasury Regulations.

Petitioner derives its "per se rule" from language in Example 7 to Treasury Regulation § 1.513-1(d)(4)(iv), adopted in 1967, which states that a professional association's publication of advertising "designed and selected in the manner of ordinary commercial advertising is not an educational activity." Pet. App. 52a-53a. In so doing petitioner fails to take into account the remaining language of Example 7, which clearly distinguishes the advertisements hypothesized there from those of respondent. Petitioner also fails to give sufficient weight to the relevant, generally applicable substantive provision of Treasury Regulation § 1.513-1(d)(2), stating that activities are "substantially related" to an organization's tax-exempt purposes if they "contribute importantly to the accomplishment of those purposes," and that whether given activities

meet this test "depends in each case upon the facts and circumstances involved." In light of the full language of the Treasury Regulations, and in light of the language and purpose of Section 513(a) of the Internal Revenue Code, Example 7 simply cannot be construed to impose a tax on respondent's advertising. If it were so construed, it would plainly be invalid.[4]

1. The Language Of Example 7 Of The Regulations Does Not Impose A Tax On The Advertising Revenues Of Respondent.

Example 7 to Treasury Regulation § 1.513-1(d)(4)(iv) does not create a "per se rule" applicable to advertising of the type published by respondent. This example does nothing more than apply the substantial relationship test to a set of hypothetical "facts and circumstances" that differs greatly from the present case. In Example 7 the "form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products," and "the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising."

By contrast, the advertisements at issue in the present case, which are primarily advertisements for prescription

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[4] Respondent, an organization exempt under Section 501(c)(3) of the Internal Revenue Code, contends that Example 7 is not at issue here because the Example by its terms is applicable only to organizations exempt under Section 501(c)(6) of the Code. Amici, as organizations exempt under Section 501(c)(6), take no position with respect to this contention of respondent. Amici wish to note, however, that Example 7 expressly recognizes that an organization exempt under Section 501(c)(6) may have as one of its tax-exempt purposes the "continuing education of its members in matters pertaining to their profession."

drugs,[5] are quite different in several respects. Advertisements for prescription drugs are *not* "designed and selected in the manner of ordinary commercial advertising." No less an authority than the Commissioner of the Food and Drug Administration has testified before Congress that drug advertising "differs from advertising of . . . other items in our economy." *See* pages 15-16, *supra*. The "form, content, and manner of presentation" of such advertising are not "governed by the basic objective of the advertisers to promote the sale of the advertised products." Rather, they are closely regulated by the Food and Drug Administration. Drug advertisements contain detailed and essential information mandated by Section 502(n) of the Food, Drug and Cosmetic Act, 21 U.S.C. § 352(n), and regulations of the FDA thereunder, codified at 21 C.F.R. Part 202. These advertisements are used by physicians as an integral part of their continuing education, J.A. 38a, 43a, and in fact are actively sought out by physicians to enhance and update their medical knowledge. The informational function of such advertising is not, as in the case of the advertising in Example 7, merely "incidental;" it is substantial and it contributes importantly to respondent's exempt educational purpose.

In order to make Example 7 apply to respondent's advertising, petitioner is forced to argue that the intent of the Example is to declare *all* advertising in professional journals to be taxable (Pet. Brf., p. 27). Such a construction is plainly inconsistent with the statement in Treas. Reg. § 1.513-1(d)(2) that the "facts and circumstances" of "each case" must be examined. Furthermore, if this had been the intent of the regulations, it is wholly

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[5] Much of respondent's non-drug advertising is for medical employment opportunities. This is also outside the scope of Example 7, which relates to "products."

improbable that the rule would have been stated in the context of a factually-oriented Example. Indeed, if the Treasury Department had intended to tax all advertising revenues received by professional journals, it would not have bothered to issue Examples 6 and 7 at all.

2. If Example 7 Of The Regulations Were Construed As Urged By Petitioner, It Would Be Invalid Because Of Its Inconsistency With The Statute And The Substantive Provisions Of The Regulations.

To the extent Example 7 purports to declare *any* kind of advertising income taxable merely because the advertising is "designed and selected in the manner of ordinary commercial advertising," the Example must be held invalid. The comparability of an activity of a tax exempt organization to "ordinary commercial" activities is simply not determinative of whether the activity is "substantially related" to the purposes of the organization within the meaning of Section 513(a) of the Code. The legislative history of Section 513(a) and Internal Revenue Service rulings under that Section contain countless examples of activities held to be "substantially related" despite being conducted in an "ordinary commercial" manner, such as college football games, museum gift shops, and hospital cafeterias. *See* pages 9, 11-13, *supra*. Moreover, such a reading of Example 7 brings it into direct conflict with the substantive provisions of Treas. Reg. § 1.513-1(d)(2).

Example 7 is part of an interpretive regulation promulgated under Section 7805(a) of the Internal Revenue Code. As such, it is not entitled to the same deference as a regulation issued under a specific grant of authority to the Commissioner of Internal Revenue. *United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982). It was, moreover, adopted some 17 years after the statute it purports to interpret, and thus hardly constitutes a "contemporane-

ous construction" of that statute. Finally, because it is an example and not a substantive regulation, it constitutes little more than an advisory opinion issued on a truncated set of hypothetical facts.

In light of the foregoing, whatever presumptions may normally exist in favor of a Treasury Regulation (Pet. Brf., p. 33) do not save Example 7 as construed by petitioner. This Court has repeatedly held that "[a] regulation which . . . operates to create a rule out of harmony with the statute, is a mere nullity." *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 134 (1936); *see also, Commissioner v. Acker*, 361 U.S. 87, 92 (1959). "[W]here . . . the provisions of the [statute] are unambiguous, and its directions specific, there is no power to amend it by regulation." *Koshland v. Helvering*, 298 U.S. 441, 447 (1936). Recent decisions of this and other courts have not hesitated to invalidate interpretations of the tax laws by the Treasury Department containing infirmities similar to those present here. *See, e.g., Commissioner v. Engle*, 464 U.S. 206 (1984); *United States v. Vogel Fertilizer Co.*, 455 U.S. 16 (1982); *United States v. Cartwright*, 411 U.S. 546 (1973); *Jones v. Commissioner*, 743 F.2d 1429 (9th Cir. 1984); *State of Washington v. Commissioner*, 692 F.2d 128 (D.C. Cir. 1982); *American Standard, Inc. v. United States*, 602 F.2d 256 (Ct. Cl. 1979).

B. Taxation Of Respondent's Advertising Revenues Is Not Justified By The 1969 Amendment Or The Legislative History Of That Amendment.

Petitioner argues that Section 513(c), which was added to the Internal Revenue Code as part of the Tax Reform Act of 1969, and the legislative history of that provision support its contention that respondent's advertising is per se taxable. Section 513(c) plainly has no such effect, and reports of Congressional committees in 1969 do not and cannot alter the meaning of Section 513(a) as enacted in 1950.

1. Section 513(c) Does Not Apply A Per Se Rule To Tax Advertising Revenues Of The Type Involved In This Case.

Prior to the enactment of Section 513(c), a single component of a "trade or business" which, considered in its entirety, was related to an organization's exempt purpose was not subject to the unrelated business income tax. *See American College of Physicians v. United States*, 530 F.2d 930 (Ct. Cl. 1976); *Massachusetts Medical Society v. United States*, 514 F.2d 153 (1st Cir. 1975). Section 513(c) merely removed this impediment to the taxation of a component of an overall exempt activity when that component was "not substantially related" to the organization's exempt purpose. *Section 513(c) does not, however, address whether a component of an overall activity is related or unrelated.* It merely treats such component as a separate trade or business. Each component must then be tested under the standard of Section 513(a).

Congress undoubtedly could have made all advertising taxable, but it did not do so. Instead, it enacted a broad rule applicable equally to *all* activities of tax-exempt organizations, not just advertising. Thus, the analysis of the advertising content of a medical journal to determine whether or not such advertising is substantially related to the organization's exempt purposes is the same as the analysis involved in any case in which an overall activity consists of two or more severable activities. *See Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1978) (sales of prescription drugs by hospital pharmacy to patients of hospital (related), to patients of hospital staff physicians (related), and to public (unrelated)—sale-by-sale analysis required). Such an analysis is precisely what the Court of Appeals undertook in this case.

2. The Legislative History Of Section 513(c) Does Not Indicate An Intent To Tax Advertising Revenues Of The Type Involved In This Case.

In its brief, petitioner suggests that the legislative history to the 1969 amendment demonstrates Congress' intent to adopt the per se rule advanced by petitioner. This is not true.

The bulk of the comments regarding Section 513(c) in both the House and Senate Reports on the Tax Reform Act of 1969 relate to the specific effect of that Section, i.e., "that an activity is not to lose its identity as a trade or business merely because it is carried on within a larger aggregate of similar activities." H.R. Rept. No. 413, 91st Cong., 1st Sess. Pt. 1, at 50 (1969). To the extent the Reports refer to the 1967 Treasury Regulations on advertising income or the "relatedness" requirement of Section 513(a), they do not evidence an intent to declare all advertising to be taxable.

The reference in the report of the House Ways and Means Committee to the 1967 regulations is qualified, stating only that "[*i*]*n general*, [the committee] is in agreement with the purpose of the regulations." *Id.* (emphasis supplied). Petitioner places great weight on the statement occurring a few lines later in this report to the effect that the committee had concluded that advertising is not related, and therefore should be taxed. Pet. Brf., p. 25. But this conclusion was obviously also meant to be "in general," for the same committee, in the technical explanation portion of its report, further describes the effect of the new Section 513(c) to be that:

> . . . the advertising contained in a publication of an exempt organization *may* be subject to the tax under section 511 even though the editorial content of the publication may be related to the exempt purposes of the organization.

H.R. Rept. No. 413, *supra*, Pt. 2, at 26 (emphasis supplied). The term "may" scarcely denotes a per se rule.

That the House had no intention of taxing advertising of the specific type published by respondent is made clear by the summary of the bill passed by the House which was prepared by the staffs of the Joint Committee on Taxation and the Senate Finance Committee. In listing arguments against the fragmentation approach of Section 513(c) that would require treating advertising as a separate activity, the staffs noted the practical problem created because

> This bill ignores the fact that it is difficult to separate technical comment (such as where technical benefits of a pharmaceutical product is described in an advertisement in a medical journal) from pure advertising.

Staffs of the Joint Comm. on Taxation and the Senate Finance Comm., 91st Cong., 1st Sess., Summary of H.R. 13270, Tax Reform Act of 1969, August 18, 1969, at 31 (Comm. Print). Obviously the staffs of these committees believed that it was necessary to "separate" medical advertising containing "technical comment" such as that in respondent's publications from "pure advertising" before applying the unrelated business income tax; if they had believed income from pharmaceutical advertisements to be taxable, there would have been no reason to consider how "difficult" it was to separate them from "pure advertising."

The report of the Senate Finance Committee, S. Rept. No. 552, 91st Cong., 1st Sess. (1969), quoted by petitioner at Pet. Brf., p. 27, does not strengthen petitioner's argument. The Senate report repeatedly states that "the committee agrees with the House" and that its members "approve the intent of the House provision." *Id.*, at 75. Thus the taxation of advertising approved by the Senate was

subject to the same "in general" qualification—and the same exclusion of "technical comment" advertising—as that approved by the House.

Knowledgeable persons within the Internal Revenue Service itself have not considered the 1969 congressional action to result in the taxation of all advertising, as demonstrated by the statement made in 1976 by an attorney in the Exempt Organizations Technical Branch of the IRS, expressing his own views, that "[t]he question of which advertising, if any, is related may be a fertile area for future litigation." Nonberg, *Taxation of Advertising in Exempt Organization Publications*, Tax Mgmt. Memo. 76-12, at 7 (1976).

3. The 1969 Legislative History Of Section 513(c) Cannot Change The Plain Meaning Of Section 513(a), Enacted In 1950.

Even if the legislative history of Section 513(c) supported petitioner's "per se rule," it would not provide a basis for reversing the application of Section 513(a) by the court below. The only *statutory* change made by Congress in 1969 was the adoption in Section 513(c) of the fragmentation principle. Congress did *nothing* to change Section 513(a), which still must be applied to each of the components of the overall activity. If Congress had intended to decree that all advertising activities are unrelated trades or businesses, it could have done so by simple and clear amendment to the Code. It did not do so.

Congress cannot without amending a statute add something which is not there. *Commissioner v. Acker*, 361 U.S. 87, 93 (1959). In this case Congress did not amend Section 513(a); it merely commented upon Section 513(a) in committee reports. Such reports obviously cannot overrule the language and structure of the statute and are of little value in determining its meaning, especially when

they are made long after the statute's enactment. As stated by the Court in *United States v. Price*, 361 U.S. 304, 313 (1960):

> [T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.

Accord, Tennessee Valley Authority v. Hill, 437 U.S. 153, 193 (1978); *Securities and Exchange Commission v. Sloan*, 436 U.S. 103, 121 (1978).

Because the intent of Congress in enacting the provisions of Section 513(a) in 1950 is clear, any inconsistent intent expressed in Congressional committee reports some 19 years later is of no effect. If Congress wishes to change the meaning of Section 513(a), it must do so by statutory enactment, not by "legislative history" created years after the fact.

C. Neither The Commercial Nature Of Respondent's Advertising Nor Considerations Of Administrative Convenience Support Taxation Of Respondent's Advertising Income.

Petitioner argues that policy considerations support taxation of respondent's advertising. It contends that because respondent conducts a "commercial advertising business" in competition with other publishers, and because respondent supposedly "was motivated entirely by revenue raising . . . concerns," it should pay tax on its advertising profits "just as any other publisher would have to do." Pet. Brf., pp. 41, 43. The difficulty with this argument is that it has no statutory basis and is flatly inconsistent with the treatment of tax-exempt organizations embodied in the Internal Revenue Code. On numerous occasions the courts and the Internal Revenue Service itself have held that a commercial mode of operation, a revenue-raising purpose, and the existence of commercial competitors do not render taxable an activity related to an organization's tax-exempt purpose. *E.g.*, Rev. Rul. 73-104, *supra* (sale

of greeting cards); Rev. Rul. 74-399, *supra* (operation of restaurant); *San Antonio Bar Association v. United States*, 80-2 U.S. Tax Cas. (CCH) ¶ 9594 (W.D. Tex. 1980) (sale of legal forms); *Edward Orton, Jr. Ceramic Foundation v. Commissioner*, 56 T.C. 147 (1971); *nonacq.* 1972-2 C.B. 4 (sale of pyrometric cones). Indeed, as petitioner admits, the subscription income received by respondent from its supposedly commercially competitive journal "is unquestionably exempt from tax." Pet. Brf., p. 43. The statutory touchstone is the existence of a substantial relationship between the activity and an organization's tax-exempt purpose, and it is the policy of the tax laws to exempt such activities from taxation regardless of how many organizations wish to participate in them.

Petitioner also argues that conducting a case-by-case examination of whether advertising is related "would entail formidable burdens on IRS audit resources". Pet. Brf., p. 42. This, however, is exactly what the IRS does with respect to activities of tax-exempt organizations other than advertising, apparently without disabling effects. *See, e.g., Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1982); Rev. Rul. 73-105, 1973-1 C.B. 264. Moreover, Congress passed Section 513(c) in 1969 despite the concern expressed by the staffs of its committees that "it is difficult to separate technical comment (such as where technical benefits of a pharmaceutical product is described in an advertisement in a medical journal) from pure advertising." Staffs of the Joint Comm. on Taxation and the Senate Finance Comm., 91st Cong., 1st Sess., Summary of H.R. 13270, Tax Reform Act of 1969, August 18, 1969, at 31 (Comm. Print), discussed at page 24, *supra*. Plainly Congress did not have the same worry about "IRS audit resources" that petitioner expresses. In any event, the "bureaucratic convenience" of establishing a "bright-line rule" cannot justify a construction of a Treasury Regula-

tion that produces a result inconsistent with the intent of the Internal Revenue Code provision being applied. *Jones v. Commissioner*, 743 F.2d 1429, 1433 (9th Cir. 1984). *See also Commissioner v. Engle*, 464 U.S. 206, 227 (1984).

CONCLUSION

For the reasons stated herein, the judgment of the Court below should be affirmed.

Respectfully submitted,

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